SALES TAX FAIRNESS AND SIMPLIFICATION ACT

HEARING

BEFORE THE

SUBCOMMITTEE ON
COMMERCIAL AND ADMINISTRATIVE LAW

OF THE

COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

FIRST SESSION

ON

H.R. 3396

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SALES TAX FAIRNESS AND SIMPLIFICATION ACT

THURSDAY, DECEMBER 6, 2007

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The Subcommittee met, pursuant to notice, at 10:06 a.m., in room 2237, Rayburn House Office Building, the Honorable Linda Sánchez (Chairwoman of the Subcommittee) presiding.

Present: Representatives Conyers, Sánchez, Lofgren, Delahunt, Cohen, Johnson, and Cannon.

Staff present: Norberto Salinas, Majority Counsel; Stewart Jeffries, Minority Counsel; and Adam Russell, Majority Professional Staff Member.

Ms. SÁNCHEZ. This hearing of the Committee on the Judiciary Subcommittee on Commercial and Administrative Law will now come to order. I will recognize myself first for a short statement.

A recently released report on e-commerce revealed that online sales on Cyber Monday, 2007, the Monday following the Thanksgiving weekend, were $733 million, a 21 percent increase from the same shopping day last year. And the total online sales for this holiday season are predicted to be $29.5 billion, an increase of $5 billion from the same shopping period last year.

These numbers reflect the growing number of consumers who see the benefits of shopping online: no waiting in line, no traffic to deal with, no parking hassles, and the convenience of items being shipped to your front door. But there is an additional benefit that some consumers enjoy when purchasing items online: not having to pay sales taxes.

Some companies actually post this on their Web sites to increase sales. States currently have limited legal authority to require remote sellers to collect sales taxes on items they sell. Instead, the burden is on consumers to remit use taxes, which are the equivalent of sales taxes, to their state of residence.

However, most consumers do not, partly due to the complexity in calculating how much taxes they need to pay partly because they are not even aware of their obligation and partly because, let us face it, those who do know about the obligation are actually going to go out of their way to avoid paying additional taxes for their purchases.

State and local governments have voiced their concerns that the increasing online sales and the resulting loss in collection of sales taxes are affecting an ever-larger portion of their revenue. On the other hand, online businesses remind us that the Supreme Court has ruled that States do not require them to collect sales taxes and remit them to the States because the tax systems are overly complex.

In an effort to remedy this issue, Congressman Delahunt has introduced H.R. 3396. H.R. 3396 will give Congress' consent to the Streamlined Sales and Use Tax Agreement, which several States have entered into to simplify their sales tax system and respond to the Supreme Court's ruling. The legislation also sets forth 19 minimum simplification requirements which the States must follow to receive authorization to require remote sellers to collect sales taxes on items they sell.

[The text of the bill, H.R. 3396, follows:]

I

110TH CONGRESS
1ST SESSION

H. R. 3396

To promote simplification and fairness in the administration and collection of sales and use taxes.

IN THE HOUSE OF REPRESENTATIVES

AUGUST 3, 2007

Mr. DELAHUNT (for himself, Mr. LAHOOD, and Mr. BACHUS) introduced the following bill; which was referred to the Committee on the Judiciary

A BILL

To promote simplification and fairness in the administration and collection of sales and use taxes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Sales Tax Fairness and Simplification Act".

SEC. 2. CONSENT OF CONGRESS.

The Congress consents to the Streamlined Sales and Use Tax Agreement.

SEC. 3. SENSE OF THE CONGRESS.

(a) SALES AND USE TAX SYSTEM.—-It is the sense of the Congress that the sales and use tax system established by the Streamlined Sales and Use Tax Agreement, to the extent that it meets the minimum simplification requirements of section 6, provides sufficient simplification and uniformity to warrant Federal authorization to Member States that are parties to the Agreement to require remote sellers, subject to the conditions provided in this Act, to collect and remit the sales and use taxes of such Member States and of local taxing jurisdictions of such Member States.

(b) PURPOSE.—The purpose of this Act is to—

(1) effectuate the limited authority granted to Member States under the Streamlined Sales and Use Tax Agreement; and

(2) not grant additional authority unrelated to the accomplishment of the purpose described in paragraph (1).

SEC. 4. AUTHORIZATION TO REQUIRE COLLECTION OF SALES AND USE TAXES.

(a) GRANT OF AUTHORITY.—

(1) IN GENERAL.—Each Member State under the Streamlined Sales and Use Tax Agreement is authorized, subject to the requirements of this section, to require all sellers not qualifying for the small business exception provided under subsection (d) to collect and remit sales and use taxes with respect to remote sales sourced to that Member State under the Agreement.

(2) REQUIREMENTS FOR AUTHORITY.—The authorization provided under paragraph (1) shall be granted once all of the following have occurred:

(A) 10 States comprising at least 20 percent of the total population of all States imposing a sales tax, as determined by the 2000 Federal census, have petitioned for membership and have become Member States under the Agreement.

(B) The following necessary operational aspects of the Agreement have been implemented by the Governing Board:

(i) Provider and system certification.

(ii) Setting of monetary allowance by contract with providers.

(iii) Implementation of an on-line multistate registration system.

(iv) Adoption of a standard form for claiming exemptions electronically.

(v) Establishment of advisory councils.

(vi) Promulgation of rules and procedures for dispute resolution.

(vii) Promulgation of rules and procedures for audits.

(viii) Provisions for funding and staffing the Governing Board.

(C) Each Member State has met the requirements to provide and maintain the databases and the taxability matrix described in the Agreement, pursuant to requirements of the Governing Board.

(3) LIMITATION OF AUTHORITY.—The authorization provided under paragraph (1)—

(A) shall be granted notwithstanding any other provision of law; and

(B) is dependent upon the Agreement, as amended, meeting the minimum simplification requirements of section 6.

(b) TERMINATION OF AUTHORITY.—

(1) IN GENERAL.—The authorization provided under subsection (a) shall terminate for all States if—

(A) the requirements contained in subsection (a) cease to be satisfied; or

(B) any amendment adopted to the Agreement after the date of enactment of this Act is not within the scope of the administration of sales and use taxes or taxes on telecommunications services by the Member States.

(2) LOSS OF MEMBER STATE STATUS.—The authorization provided under subsection (a) shall terminate for a Member State, if such Member State no longer meets the requirements for Member State status under the terms of the Agreement.

(c) DETERMINATION OF STATUS.—

(1) IN GENERAL.—The Governing Board shall determine if Member States are in compliance with the requirements of subsections (a) and (b).

(2) COMPLIANCE DETERMINATION.—Upon the determination of the Governing Board that all the requirements of subsection (a) have been satisfied, the authority of each Member State to require a seller to collect and remit sales and use taxes shall commence on the first day of a calendar quarter at least 6 months after the date the Governing Board makes its determination.

(d) SMALL BUSINESS EXCEPTION.—No seller shall be subject to a requirement of any State to collect and remit sales and use taxes with respect to a remote sale if—

(1) the seller and its affiliates collectively had gross remote taxable sales nationwide of less than $5,000,000 in the calendar year preceding the date of such sale; or

(2) the seller and its affiliates collectively meet the $5,000,000 threshold of this subsection but the seller has less than $100,000 in gross remote taxable sales nationwide.

SEC. 5. DETERMINATIONS BY GOVERNING BOARD AND JUDICIAL REVIEW OF SUCH DETERMINATIONS.

(a) PETITION.—At any time after the Governing Board has made the determination required under section 4(c)(2), any person who may be affected by the Agreement may petition the Governing Board for a determination on any issue relating to the implementation of the Agreement.

(b) REVIEW IN COURT OF FEDERAL CLAIMS.—Any person who submits a petition under subsection (a) may bring an action against the Governing Board in the United

States Court of Federal Claims for judicial review of the action of the Governing Board on that petition if—

(1) the petition relates to an issue of whether—

(A) a Member State has satisfied or continues to satisfy the requirements for Member State status under the Agreement;

(B) the Governing Board has performed a nondiscretionary duty of the Governing Board under the Agreement;

(C) the Agreement continues to satisfy the minimum simplification requirements set forth in section 6; or

(D) any other requirement of section 4 has been satisfied; and

(2) the petition is denied by the Governing Board in whole or in part with respect to that issue, or the Governing Board fails to act on the petition with respect to that issue not later than 6 months after the date on which the petition is submitted.

(c) TIMING OF ACTION FOR REVIEW.—An action for review under this section shall be initiated not later than 60 days after the denial of the petition by the Governing Board, or, if the Governing Board failed to act on the petition, not later than 60 days after the end of the 6-month period beginning on the day after the date on which the petition was submitted.

(d) STANDARD OF REVIEW.—

(1) IN GENERAL.—In any action for review under this section, the court shall set aside the actions, findings, and conclusions of the Governing Board found to be arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.

(2) REMAND.—If the court sets aside any action, finding, or conclusion of the Governing Board under paragraph (1), the court shall remand the case to the Governing Board for further action consistent with the decision of the court.

(e) JURISDICTION.—

(1) GENERALLY.—Chapter 91 of title 28, United States Code, is amended by adding at the end the following:

"SEC. 1510. JURISDICTION REGARDING THE STREAMLINED SALES AND USE TAX AGREEMENT.

"The United States Court of Federal Claims shall have exclusive jurisdiction over actions for judicial review of determinations of the Governing Board of the Streamlined Sales and Use Tax Agreement under the terms and conditions provided in section 5 of the Sales Tax Fairness and Simplification Act.".

(2) CONFORMING AMENDMENT TO TABLE OF SECTIONS.—The table of sections at the beginning of chapter 91 of title 28, United States Code, is amended by adding at the end the following new item:

"1510. Jurisdiction regarding the streamlined sales and use tax agreement.".

SEC. 6. MINIMUM SIMPLIFICATION REQUIREMENTS.

(a) IN GENERAL.—The minimum simplification requirements for the Agreement, which shall relate to the conduct of Member States under the Agreement and to the administration and supervision of such conduct, are as follows:

(1) A centralized, one-stop, multistate registration system that a seller may elect to use to register with the Member States, provided a seller may also elect to register directly with a Member State, and further provided that privacy and confidentiality controls shall be placed on the multistate registration system so that it may not be used for any purpose other than the administration of sales and use taxes. Furthermore, no taxing authority within a Member State or a Member State that has withdrawn or been expelled from the Agreement may use registration with the centralized registration system for the purpose of, or as a factor in determining, whether a seller has a nexus with that Member State for any tax at any time.

(2) Uniform definitions of products and product-based exemptions from which a Member State may choose its individual tax base, provided, however, that all local jurisdictions in that Member State shall have a common tax base identical to the State tax base of that Member State. A Member State may enact other product-based exemptions without restriction if the Agreement does not have a definition for the product or for a term that includes the product. A Member State shall relax the good faith requirement for acceptance of exemption certificates in accordance with section 317 of the Agreement, as amended through the date of enactment of this Act.

(3) Uniform rules for sourcing and attributing transactions to particular taxing jurisdictions.

(4) Uniform procedures for the certification of service providers and software on which a seller may elect to rely in order to determine Member State sales and use tax rates and taxability.

(5) Uniform rules for bad debts and rounding.

(6) Uniform requirements for tax returns and remittances.

(7) Consistent electronic filing and remittance methods.

(8) Single, State-level administration of all Member State and local sales and use taxes, including a requirement for a State-level filing of tax returns in each Member State.

(9) A single sales and use tax rate per taxing jurisdiction, except that a State may impose a single additional rate, which may be zero, on food, food ingredients, and drugs, provided that this limitation does not apply to the items identified in section 308 C of the Agreement, as amended through the date of enactment of this Act.

(10) A Member State shall eliminate caps and thresholds on the application of sales and use tax rates and exemptions based on value, provided that this limitation does not apply to the items identified in section 308 C of the Agreement, as amended through the date of enactment of this Act.

(11) A provision requiring each Member State to complete a taxability matrix, as adopted by the Governing Board. The matrix shall include information regarding terms defined by the Agreement in the Library of Definitions. The matrix shall also include, pursuant to the requirements of the Governing Board, information on use, entity, and product based exemptions.

(12) A provision requiring that each Member State relieves a seller or service provider from liability to that Member State and local jurisdiction for collection of the incorrect amount of sales or use tax, and relieves the purchaser from penalties stemming from such liability, provided that collection of the improper amount is the result of relying on information provided by that Member State regarding tax rates, boundaries, or taxing jurisdiction assignments, or in the taxability matrix regarding terms defined by the Agreement in the Library of Definitions.

(13) Audit procedures for sellers, including an option under which a seller not qualifying for the small business exception in section 4(d) may request, by notifying the Governing Board, to be subject to a single audit on behalf of all Member States for sales and use taxes (other than use taxes on goods and services purchased for the consumption of the seller). The Governing Board, in its discretion, shall authorize such a single audit.

(14) As of the day that authority to require collection commences under section 4, each Member State shall provide reasonable compensation for expenses incurred by a seller directly in administering, collecting, and remitting sales and use taxes (other than use taxes on goods and services purchased for the consumption of the seller) to that Member State. Such compensation may vary in each Member State depending on the complexity of the sales and use tax laws in that Member State and may vary by the characteristics of sellers in order to reflect differences in collection costs. Such compensation may be provided to a seller or a third party service provider whom a seller has contracted with to perform all the sales and use tax responsibilities of a seller.

(15) Appropriate protections for consumer privacy.

(16) Governance procedures and mechanisms to ensure timely, consistent, and uniform implementation and adherence to the principles of the streamlined system and the terms of the Agreement.

(17) Each Member State shall apply the simplification requirements of the Agreement to taxes on telecommunications services, except as provided herein. This requirement is applicable to Member States as of July 1, 2010, except that sales and use taxes on telecommunications services shall be subject to the Agreement and the authority granted to the Member States when the requirements of section 4(a) are met. On or after July 1, 2010, for those Member States which meet the requirements of this paragraph, the authority granted such Member States under section 4 may be exercised by such Member States, pursuant to the terms of section 4 and section 5, with respect to taxes on telecommunications services other than sales and use taxes on such services. The following are exceptions to the requirement established under this paragraph:

(A) The requirement for one uniform return shall not apply, provided, however, there shall be one uniform return for each type of tax on telecommunications services within a State.

(B) The requirements for rate simplification are modified to require that each taxing jurisdiction shall have only one rate for each type of tax on telecommunications services.

(C) The requirements for tax base uniformity in section 302 of the Agreement shall apply to each type of tax on telecommunications services within a State, but shall not be construed to require that the tax base for different types of taxes on telecommunications services must be identical to the tax base for sales and use taxes imposed on telecommunications services.

(18) Uniform rules and procedures for "sales tax holidays".

(19) Uniform rules and procedures to address refunds and credits for sales taxes relating to customer returns, restocking fees, discounts and coupons, and rules to address allocations of shipping and handling and discounts applied to multiple item and multiple seller orders.

(b) REQUIREMENT TO PROVIDE SIMPLIFIED TAX SYSTEMS.—

(1) IN GENERAL.—The requirements of this section are intended to ensure that each Member State provides and maintains the necessary simplifications to its sales and use tax system to warrant the collection authority granted to it in section 4.

(2) REDUCTION OF ADMINISTRATIVE BURDENS.—The requirements of this section should be construed—

(A) to require each Member State to substantially reduce the administrative burdens associated with sales and use taxes; and

(B) as allowing each Member State to exercise flexibility in how these requirements are satisfied.

(3) EXCEPTION.—In instances where exceptions to the requirements of this section can be exercised in a manner that does not materially increase the administrative burden on a seller obligated to collect or pay the taxes, such exceptions are permissible.

SEC. 7. LIMITATION.

(a) IN GENERAL.—-Nothing in this Act shall be construed as—

(1) subjecting a seller to franchise taxes, income taxes, or licensing requirements of a Member State or political subdivision thereof; or

(2) affecting the application of such taxes or requirements or enlarging or reducing the authority of any Member State to impose such taxes or requirements.

(b) NO EFFECT ON NEXUS, ETC.—

(1) IN GENERAL.—No obligation imposed by virtue of the authority granted by section 4 shall be considered in determining whether a seller has a nexus with any Member State for any other tax purpose.

(2) PERMISSIBLE MEMBER STATE AUTHORITY.—Except as provided in subsection (a), and in section 4, nothing in this Act permits or prohibits a Member State from—

(A) licensing or regulating any person;

(B) requiring any person to qualify to transact intrastate business;

(C) subjecting any person to State taxes not related to the sale of goods or services; or

(D) exercising authority over matters of interstate commerce.

SEC. 8. EXPEDITED JUDICIAL REVIEW.

(a) THREE-JUDGE DISTRICT COURT HEARING.—Notwithstanding any other provision of law, any civil action challenging the constitutionality of this Act, or any provision thereof, shall be heard by a district court of three judges convened pursuant to the provisions of section 2284 of title 28, United States Code.

(b) APPELLATE REVIEW.—

(1) IN GENERAL.—Notwithstanding any other provision of law, an interlocutory or final judgment, decree, or order of the court of three judges in an action under subsection (a) holding this Act, or any provision thereof, unconstitutional shall be reviewable as a matter of right by direct appeal to the Supreme Court.

(2) 30-DAY TIME LIMIT.—Any appeal under paragraph (1) shall be filed not more than 30 days after the date of entry of such judgment, decree, or order.

SEC. 9. DEFINITIONS.

For the purposes of this Act the following definitions apply:

(1) AFFILIATE.—The term "affiliate" means any entity that controls, is controlled by, or is under common control with a seller.

(2) GOVERNING BOARD.—The term "Governing Board" means the governing board established by the Streamlined Sales and Use Tax Agreement.

(3) MEMBER STATE.—The term "Member State"—

(A) means a Member State as that term is used under the Streamlined Sales and Use Tax Agreement as of the date of enactment of this Act; and

(B) does not include associate members under the Agreement.

(4) NATIONWIDE.—The term "nationwide" means throughout each of the several States and the District of Columbia, the Commonwealth of Puerto Rico, Guam, American Samoa, the Virgin Islands, the Northern Mariana Islands, and any other territory or possession of the United States.

(5) NONDISCRETIONARY DUTY OF THE GOVERNING BOARD.—The phrase "nondiscretionary duty of the Governing Board" means any duty of the Governing Board specified in the Agreement as a requirement for action by use of the term "shall", "will", or "is required to".

(6) PERSON.—The term "person" means an individual, trust, estate, fiduciary, partnership, corporation, or any other legal entity, and includes a State or local government.

(7) REMOTE SALE.—The term "remote sale" refers to a sale of goods or services attributed to a particular Member State with respect to which a seller does not have adequate physical presence to establish nexus under the law existing on the day before the date of enactment of this Act so as to allow such Member State to require, without regard to the authority granted by this Act, the seller to collect and remit sales or use taxes with respect to such sale.

(8) REMOTE SELLER.—The term "remote seller" means any seller who makes a remote sale.

(9) STATE.—The term "State" means any State of the United States of America and includes the District of Columbia, Puerto Rico, and any other territory or possession of the United States.

(10) STREAMLINED SALES AND USE TAX AGREEMENT.—The term "Streamlined Sales and Use Tax Agreement" (or "the Agreement") means the multistate agreement with that title adopted on November 12, 2002, as amended through the date of enactment of this Act and unless the context otherwise indicates as further amended from time to time.

(11) TAX ON TELECOMMUNICATIONS SERVICES.—The term "tax on telecommunications services" or "taxes on telecommunication services" shall encompass the same taxes, charges, or fees as are included in section 116 of title 4, United States Code, except that "telecommunication services" shall replace "mobile telecommunications services" whenever such term appears.

(12) TELECOMMUNICATIONS SERVICE.—

(A) IN GENERAL.—The term "telecommunications service" means the electronic transmission, conveyance, or routing of voice, data, audio, video, or any other information or signals to a point, or between or among points.

(B) INCLUSION.—The term "telecommunication service"—

(i) includes transmission services in which computer processing applications are used to act on the form, code, or protocol of the content for purposes of transmission, conveyance, or routing without regard to whether such services are referred to as voice over Internet protocol services or are classified by the Federal Communications Commission as enhanced or value added services; and

(ii) does not include the data processing and information services that allow data to be generated, acquired, stored, processed, or retrieved and delivered by an electronic transmission to a purchaser where the primary purpose of such purchaser for the underlying transaction is the processed data or information.

SEC. 10. SENSE OF THE CONGRESS ON DIGITAL GOODS AND SERVICES.

It is the sense of the Congress that each State that is a party to the Agreement should work with other States that are also party to the Agreement to prevent double taxation in situations where a foreign country has imposed a transaction tax on a digital good or service.

Ms. SÁNCHEZ. Today's hearing serves three purposes. First, the witnesses will help us understand whether there is a need for a simplified sales and use tax system. Second, this hearing will provide us with an opportunity to hear about the progress that States have made in coming to an agreement to simplify their sales and use tax system. And finally, the testimony will help us determine how soon the States can meet the requirements established in H.R. 3396 and whether the legislation fully addresses the concerns of consumers, States and businesses.

We have four witnesses with us this morning to testify about the issues addressed by H.R. 3396 and to answer our questions about the legislation and the agreement and what impact H.R. 3396 would have on consumers, business and States' local revenue. Accordingly, I look forward to today's hearing.

I now recognize my colleague and distinguished Ranking Member, Mr. Cannon and the co-author of the bill that we are examining today for his opening remarks.

Mr. CANNON. I thank you, Madam Chair. I am pleased that we are holding this hearing after the passage of the Internet Tax Act Amendments of 2007. In years past, these issues have become intertwined. I appreciate the leadership of Chairman Conyers and Chairwoman Sánchez in keeping them separate during the consideration of Internet tax moratorium.

The Streamlined Sales Tax and Use Agreement, which is now expanded—I am trying to figure out whether we should call it the SST, which seems simpler and more innocuous, or the SSUTA, which is a little more cumbersome. I think it deserves the cumbersome title. But I may lapse into the SST.

This agreement was borne out of a desire to simplify and reduce the administrative burden of imposing sales taxes for businesses. And it was also designed to drive a framework for the remote collection of sales taxes.

And this was done to address two decisions by the U.S. Supreme Court that held that States cannot compel out-of-state vendors—that is businesses that do not have any physical nexus with the State—to collect and remit the sales tax owed by that State's residents. With the growth of Internet commerce, there is concern on behalf of many States that their sales tax revenues will decline as more consumers buy goods from retailers that the States cannot compel to collect sales taxes.

A 2000 study conducted by two University of Tennessee professors showed that by 2006 the total sales that would be lost to States due to e-commerce would be about $45 billion. I thought that laughable years ago when we first viewed that study. And those authors have revised their study repeatedly, and the latest estimate is that States and local governments will lose in uncollected sales taxes between $21.5 billion and $32.6 billion in 2008.

However, these numbers are not beyond dispute. Direct Marketing Association estimates that in 2006 States lost only $4.2 billion, less than 10 percent of what the Tennessee study estimated.

Further, as more e-commerce is transacted on the Web sites than more traditional brick and mortar stores, the so-called—I call them the click and brick stores—the number of sales that are conducted tax-free continues to decline. That is because the click and brick stores have a physical presence in many taxing jurisdictions and accordingly, collect taxes in those jurisdictions, even for sales on the Internet.

In fact, forbes.com recently reported that one of the authors of the original University of Tennessee study estimates that 50 percent of all sales taxes—or all sales conducted on the Internet are subject to sales taxes. So while I appreciate the concerns of the States involved in this process, it appears to me that many of the original reasons for implementing a streamlined sales agreement have not materialized and, in fact, are being gradually abated by the presence of the so-called click and brick enterprises.

Further, while I laud the goals of a streamline tax, it seems to me that the SST or the SSUTA as it has been implemented is not streamlined at all. The agreement as it exists today is over 130 pages, been modified no less than 10 times in its 5-year history. If Congress enacts H.R. 3396, I fear that we will be giving our imprimatur to something that is just a work in progress.

Which brings me to my final point. If Congress enacts H.R. 3396, it would require businesses in all 50 States, including the 5 States that have no sales tax, to collect and remit sales taxes—sales and use taxes—to the 17 States that actually have implemented the SSUTA. This is different from the approach that Congress usually takes when it approves interstate compacts.

That is, permitting the States in the compact to share resources. Rather, H.R. 3396 would require businesses in States that are not party to the SSUTA to, in effect, participate against their will.

Madam Chair, while I commend you for holding a hearing on this legislation, I would much prefer that we think of other issues affecting interstate commerce and discriminatory taxes. To that end, may I suggest the Subcommittee hold hearings on bills that prevent the States from imposing discriminatory taxes on pipelines, rental cars and multi-channel video services? I hope the Subcommittee will deal with these issues next session, in the interest of putting more money into the pockets of consumers and less in the coffers of tax collectors.

And may I just say as a final note that it has been a great pleasure to work with Mr. Delahunt on this issue over a very long period of time. He is expert in these issues, and our disagreements tend to be relatively minor and pleasant. And I appreciate that, Madam Chair, and yield back.

Ms. SÁNCHEZ. I thank the gentleman for his statement. I want to apologize. I misspoke earlier when I introduced you. I said that you were a co-author of the bill. And I understand that you are not. I apologize. My apologies——

Mr. CANNON. But a dear friend was the author.

Ms. SÁNCHEZ. My apologies and so noted that you are a dear friend of Mr. Delahunt. And I am sure he is not offended.

Mr. CANNON. Not in the least, Madam Chair.

Ms. SÁNCHEZ. At this time, I would like to recognize for an opening statement, Mr. Conyers, the distinguished Member of our Subcommittee and the Chairman of the full Committee on the Judiciary. Mr. Conyers?

Mr. CONYERS. Thank you, Chairwoman Sánchez.

And good morning to all of you.

I commend you, Madam Chairwoman, for holding hearings on the important legislation, and I was just busily lining out my commendations to Chris Cannon before I found out he was not a sponsor of the bill. But he is still a good friend.

I join Bill Delahunt and the gentleman from Alabama, Mr. Bachus and others, Ray LaHood, in looking at this very important question. And I think that holding hearings about a simplified, streamlined tax agreement could increase our Nation's economic efficiency, facilitate the growth of electronic commerce, and help our States and local government maintain financial support for public health, education, safety.

And so, I come here with the encouragement of my governor, Jennifer Granholm, who has lost somewhere between $700 million and $1.1 billion in foregone sales tax because of the complex system which we are here to examine how we can simplify. So I am very happy to join you and would ask that my statement be included in the record.

Ms. SÁNCHEZ. Without objection, so ordered.

[The prepared statement of Mr. Conyers follows:]

PREPARED STATEMENT OF THE HONORABLE JOHN CONYERS, JR., A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MICHIGAN, CHAIRMAN, COMMITTEE ON THE JUDICIARY, AND MEMBER, SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW

Sales taxes constitute a significant state and local revenue source, with the census bureau estimating that nearly one third of State and local revenues come from general sales and use taxes. With ever increasing online sales, states and local governments must plan their budgets anticipating huge revenue loses due to uncollected sales and use taxes from online sales. For example, my beloved state of Michigan is estimated to lose between $700 million and $1.1 billion in foregone sales taxes in 2008, with online sales accounting for over half of those losses. Even the most conservative estimates suggest that Michigan will lose in the hundreds of millions of dollars in 2008, at a time when the state is hemorrhaging and is in dire need of revenue to support quality education, effective public safety, and other basic services. And that is just Michigan. Think of how much each state could do to reduce class sizes, build new schools, strengthen our bridges, and protect our communities and citizens with these funds.

However, the Supreme Court has ruled that partly because the states had very complex tax systems, state do not have the authority to require out-of-state sellers to collect sales taxes. This bipartisan legislation, of which I proudly cosponsor, addresses the Supreme Court's concern for a simplified tax system. It authorizes states to develop and enter into an interstate sales and use tax agreement where states joining the agreement and adopting a simplified sales tax system would be authorized to require remote sellers to collect sales taxes. Many states have already settled on a framework and streamlined their tax code for the benefit of consumers and both small businesses and national retailers. Thus, the framework makes it easier for businesses to collect sales taxes across state lines.

I thank my colleague from Massachusetts, Mr. Delahunt, for introducing this legislation. And I am pleased that the Chair of this Subcommittee is holding this hearing on the important legislation. I believe that a simplified streamlined tax agreement would increase our nation's economic efficiency, facilitate the growth of electronic commerce, and help our states and local government maintain financial support for public education, health and safety. H.R. 3396 accomplishes this goal.

Ms. SÁNCHEZ. I want to thank Mr. Conyers for coming. And I would also like to recognize a colleague of mine from the state of California, Zoe Lofgren.

Ms. LOFGREN. Thank you, Madam Chair. And I would ask unanimous consent that my full statement be made a part of the record.

Ms. SÁNCHEZ. Without objection, so ordered.

[The prepared statement of Ms. Lofgren follows:]

PREPARED STATEMENT OF THE HONORABLE ZOE LOFGREN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA, AND MEMBER, SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE PROPERTY

Thank you Madam Chairwoman. I would also like to thank the witnesses and thank Mr. Delahunt for all of his work on this issue.

I'm sorry that I can't attend today's hearing in its entirety. Unfortunately I will have to leave shortly to chair a hearing on the use of robocalls in federal elections

Simplification and interoperation of state sales and use tax systems is a worthy goal and area in which state and local governments as well as private businesses have many shared interests.

I have watched this issue closely and with each iteration, the Streamlined Sales Tax Project and authorizing legislation gets closer to a system that is simple, fair, and does not unduly burden interstate commerce.

That being said, I am uncertain that we have reached the conclusion of this process. Numerous question and concerns remain.

For example, it is still unclear how to reconcile a dual-sourcing system that would accommodate either origin or destination sourcing with the requirement in HR 3396 to maintain uniform sourcing.

Similarly it is unclear exactly what is entailed by the bill's requirement that states provide "reason compensation for expenses incurred by the seller" in implementing the SSUTA. Given that there are over 7,500 distinct taxing jurisdictions in the United States with their own rates, exclusions, and tax holidays, compliance will be significantly more difficult and costly than simply purchasing software.

This issue takes on added significance given the initial estimates of how much revenue states are losing, and therefore would realize under SSUTA, may have relied on incorrect assumptions.

Obviously these issues are very serious ones not only for online commerce, but also for states, like California, that have concluded that "conforming would require a major overhaul of the state's sales and use tax system." [California Board of Equalization.]

Member states believe that they have many of these issues solved. The best way to test that claim would be to have the SSUTA operate as a voluntary multistate compact among member states for a few years before imposing it on every state in the nation.

This would allow us to determine exactly how simplified and streamlined the SSUTA has become.

Barring that approach, I think we must continue to examine the most significant obstacles to a genuinely simplified remote sales tax system and therefore appreciate the Chairwoman's decision to hold this hearing.

Thank you.

Ms. LOFGREN. I would just note that I think this is an important hearing. I thank you and also especially Mr. Delahunt for his years of work on this issue. I am going to have to leave the hearing before it is concluded because I am chairing a hearing in another Subcommittee. But I do believe that the goal of simplification is a worthy one. However, as we all know, it is very complicated and with the over 7,500 distinct taxing jurisdictions in the United States with their own rates, exclusions, tax holidays, compliance could be tough.

I note that the state of California has indicated to me that conforming would require a major overhaul of California's sales and use tax system. California is not on board on this proposal yet, and as you know, I chair the California Democratic delegation. So we are concerned that maybe we are not there yet. But that the goal is a worthy one, and so we have many questions, and I am sure that we will have ample opportunity to review these issues. I appreciate, once again, Mr. Delahunt's leadership.

Ms. SÁNCHEZ. Thank you, Ms. Lofgren.

Now, last but certainly not least, I would like to recognize the author of this bill for his opening statement, the distinguished gentleman from Massachusetts, Mr. Delahunt.

Mr. DELAHUNT. Well, thank you, Madam Chair. And I appreciate the opportunity and your sincere efforts to see that Congress gives full consideration to the issue of taxation of remote sales. I want to thank you for scheduling this hearing and look forward to working with you and other Members of the Subcommittee to make it a productive exercise.

I also want to thank the Chair of the full Committee for his leadership on this issue, because I know it is of importance to him. And for a moment I was pleased to hear that my good friend from Utah had an epiphany, however brief. But I am sure that after listening to the testimony today he will give more consideration, more thoughtful consideration to the issue.

Every year the first days of the holiday shopping season are examined as an indicator of economic health. I can't say that I am one of those people in line at the retail stores at 5 a.m. after Thanksgiving, but so-called Black Friday has become a staple of measurement in the retail sector. In the last few years, the media coverage of those early shopping days has included a new term, Cyber Monday, when shoppers who didn't get enough of Black Friday flood online stores in search of gifts for friends and loved ones.

Well, this year Cyber Monday, which was November 26, online sales increased 21 percent over last year, 21 percent, $733 million, which was an excess of over—rather $733 million over the $610 million figure in 2006. Each of the next 3 days also surpassed $700 million in sales, resulting in more than $4 billion in online spending during the week.

More than $13.4 billion has been spent online during this year's holiday season to date, clocking an 18 percent gain versus the corresponding days of last year. Now, people will use these numbers to debate the health of the economy. But my point is simple. It is that with every passing year, the American people are fulfilling more of their retail needs online as opposed to so-called brick and mortar stores.

Why is this important? Several reasons. States have relied on sales and use taxes since 1932 for roughly one-third of their revenue. Today our States are collectively losing tens of billions of dollars each year because the taxable transactions on which they rely on are increasingly taking place over the Internet.

Adjusted retail e-commerce sales from the third quarter of 2007 were an estimated $35 billion, an increase of 3.6 percent from the second quarter of 2007 and an increase of almost 20 percent from the third quarter, the corresponding quarter of 2006, almost 20 percent. These increases far exceed overall brick and mortar retail growth.

When the remote sellers in these e-commerce transactions do not collect sales tax, the obvious result is an erosion of the sales tax base of those States that rely on this revenue stream. This amounted to State and local governments losing between $17 to $20 billion in uncollected sales and use taxes for remote transactions in the year 2004. That number is likely to go up to $66 billion by 2011 with the total loss, the aggregate coming to nearly half a trillion dollars by that date.

Put these numbers together with recent reports about the health of State budgets, and, folks, we have a serious problem. Sixteen States are facing major budget shortfalls right now largely due to the rising health care costs and housing costs. In fiscal year 2007 State budget balances are below 2006 fiscal year levels. And the downward trend is expected to carry over into fiscal year 2008, given the State of our economy.

Many of our State and local government officials are facing a stark choice between unpopular tax increases. Many will have to resort to the most aggressive of all taxes, the property tax and drastic cuts, more drastic cuts in services or maybe both.

But this issue isn't just simply about the devastating loss of revenue. It is about fairness and equity. By failing to ensure sales tax parity between remote sellers and Main Street merchants, we are putting at risk the thousands of small businesses that sustain our local economy as well as the fabric of our communities and our neighborhoods.

For example, it is that small store, the independent book store, for example, that doesn't just provide books. It sponsors the little league team, creates a venue for people to come together. It enhances, if you will, a sense of community.

If there is any bill that is supportive of the small business owner in this country, it is this legislation that is before us today. And please note it is both local and remote businesses that benefit from local infrastructure, roads, fire, and safety services in our cities and towns. But right now most remote sellers have an unfair advantage over their brick and mortar competitors.

States, cities, and towns must be empowered to level the playing field for their home town businesses. And I am not in any way opposed to the progress represented by e-commerce. I am amazed by it. But I strongly believe that fairness requires that remote sellers collect and pay the same taxes that our home town businesses on Main Street have to collect and pay.

You know, States have gone to work. They have done their jobs. And it is time that Congress recognizes that.

States went to work beginning with the creation of the streamlined sales and use tax agreement, which has served as a blueprint of States to streamline their taxation systems. In the 108th Congress, I stated back then that the States have made substantial progress and that once a sufficient number of States have implemented the agreement, Congress should move expeditiously to pass what was an earlier version of the bill that we are having this hearing on today. That bill, like the one before us, would simply bless, if you will, the agreement and authorize those member States to compel out-of-state sellers to collect and remit sales and use tax arising from sales out of the member's jurisdiction.

Our current bill also outlines minimum simplification requirements and exempts remote small businesses from any such requirement. Let me repeat. It is straightforward. It is narrowly tailored and responds directly to the Supreme Court's conclusion in Quill.

It is Congress' authority and responsibility to enable the States to develop tax policy that reflects today's economy, rather than buying into antiquated notions of what the marketplace wants. But we have yet to adopt what I believe to be common sense legislation.

Well, since October 1, 2005, approximately 1,100 remote retailers have volunteered to collect an out-of-state sales tax for these States. To date, member States have collected almost $115 million in new sales tax revenues from those volunteer sellers which previously would have been uncollected.

You know, in the 7 years since this bill was first introduced the States have organized and lined up to address the issue. They have done everything that we have asked them to do. Now that the States are meeting their responsibilities, it is long past due that the Federal Government and the United States Congress stand up and do what is clearly our responsibility.

Recognizing that the Ranking Member is from Utah, I thought it might be apropos that I conclude with a very brief quote from the former governor of Utah, the current secretary of health and human services, a good man, a man with great common sense and on this particular issue, a man of great insight and intellect. These are Secretary Leavitt's words back in 1995. And I presume I have no doubt that he continues to embrace them.

"The current sales tax is a great system of taxation for the agricultural and industrial economy it was created for. But it is unworkable now. There is no new tax involved in a streamlined sales tax system, none. Every tax obligation talked about exists today."

"Citizens know what the sales tax is and what it pays for, the schools their children attend, the roads they drive, and the fire and police departments that protect them. The new streamlined sales tax system when fully deployed treats every buyer and seller the same, no special privilege, no selected burden, just a level playing field."

"The new system is voluntary. Whether you are a New Hampshire that has no sales tax or a Nevada where sales tax comprises 80 percent of all State revenue, it is your choice. If you don't like it or you don't need it, don't use it."

I yield back, and I——

Mr. CANNON. Would the gentleman yield briefly?

Mr. DELAHUNT. Very briefly.

Mr. CANNON. I noticed the clock wasn't working as you spoke briefly.

Ms. SÁNCHEZ. I want it noted for the record the Chair has been very generous with the time.

Mr. DELAHUNT. I would note that.

Mr. CANNON. My dear friend, Mr. Leavitt, former Governor Leavitt, now Secretary Leavitt made that statement in 1995, generations ago in Internet time. And I think that the State legislature, which is now back to the Utah State Legislature, which was, I think, the first legislature to back the SST, has now pulled out and is in that standby status, and I think wisely so because time has led them to understand the difficulties of SST and the burdens that it puts on the world probably don't make sense. And that is why we are going to have this hearing.

So we will examine that in a little more, but I wanted to validate the prescience of my former governor, but it is the transformation of society that has made him less relevant. Thank you, and I yield back.

Ms. SÁNCHEZ. Well, I am glad everybody is happy about today's hearing. I hope that it will provide us with the information that we are seeking in order to make a more informed decision on where we fall on this issue.

I want to thank Mr. Delahunt for his opening statement. And without objection, other Members' opening statements will be included for the record. Without objection, the Chair will be authorized to declare a recess of the hearing at any point.

[The prepared statement of Mr. Cohen follows:]

PREPARED STATEMENT OF THE HONORABLE STEVE COHEN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TENNESSEE, AND MEMBER, SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW

STATEMENT OF REP. STEVE COHEN
HOUSE JUDICIARY COMMITTEE
SUBCOMMITTEE ON COMMERCIAL
AND ADMINISTRATIVE LAW
DECEMBER 6, 2007

The Streamline Sales and Use Tax Agreement (SSUTA) is a valuable step for states to take in addressing the problem of declining sales tax revenue that has resulted from the growth of Internet remote sales. Tennessee is one of the most sales-tax dependent states. Therefore, it is critical that it be able to capture remote sales tax revenue. Nonetheless, I would like to learn more about the progress that SSUTA member states have made in terms of the details of streamlining and unifying their sales tax systems before making any final judgment on whether Congress should give its blessing to the SSUTA.

Ms. SÁNCHEZ. And at this time, I am pleased to introduce the witnesses for today's hearing. Our first witness is Joan Wagnon. Ms. Wagnon is currently serving as secretary of revenue for the state of Kansas and was appointed to her post on January 13, 2003 by Governor Kathleen Sebelius. Is that a correct pronunciation?

Prior to her appointment, she was president of Central National Bank, Topeka, elected mayor of Topeka on April 1, 1997. Ms. Wagnon was the first woman to serve as mayor since the city's incorporation in 1867. Wow, what a breakthrough.

She also served 12 years in the Kansas House of Representatives from 1983 to 1994. Ms. Wagnon currently serves as president of the Streamlined Sales Tax Governing Board and has been an officer since the organization's inception in 2005. She also has served as chair of the Multi-State Tax Commission from 2005 to 2007 and is currently on the board of directors for the Federation of Tax Administrators.

Our second witness is Wayne Zakrzewski. Mr. Zakrzewski is a vice president and associate general counsel for tax for JCPenney Company, Incorporated where he has responsibility for all legal matters related to tax, audit of sales, use and State income taxes, property tax compliance, and value appeals, and State tax research and planning. From 1981 to 1988 he served as attorney deputy chief counsel of the Arkansas Revenue Division.

He has been an active participant in the streamlined sales tax project since its beginning and currently serves as a member of the board of directors of the Business Advisory Council to the governing board of streamlined sales tax agreement. He also served as co-chair of the steering committee for the Joint Cost and Collection Study which was a joint business and State government project to provide data concerning the cost of the current sales tax business and to provide tools to compare that cost with those costs of a streamlined business.

We welcome you to our panel.

Our third witness is George Isaacson. Mr. Isaacson is a senior partner in the law firm of Brann & Isaacson in Lewiston, Maine, which represents over 70 direct marketers and electronic merchants throughout the United States in connection with State sales use and income tax matters.

For over 15 years he has provided counsel to the Direct Marketing Association and has represented the DMA in the filing of amicus cure briefs in State and Federal court. In addition to tax advice, Mr. Isaacson also consults for direct marketers on a wide range of electronic commerce issues.

We want to welcome you as well.

Mr. Isaacson also serves as outside general counsel to L.L. Bean, Incorporated and frequently speaks before business groups and trade associations regarding legal issues affecting electronic commerce.

Our final witness is Steve Rauschenberger. Mr. Rauschenberger is president of Rauschenberger Partners, a partnership with extensive experience in government affairs, strategic development, and business management. Prior to founding the firm, Mr. Rauschenberger served for 15 years in the Illinois State Senate holding various leadership positions, including assistant Republican leader and Chairman of the Senate Appropriations Committee.

He is immediate past president of the National Conference of State Legislature where he also served as co-chair of the task force on telecommunications and electronic commerce. Prior to his tenure in government, Mr. Rauschenberger was president of Ackerman Brothers, Incorporated, which owned and operated three retail furniture stores. And before taking that position, he was a partner in the Rauschenberger Furniture Company, a third generation family furniture retail business.

We want to welcome you to our panel this morning.

We want to thank you all for your willingness to participate in today's hearing. Without objection, your written statements will be placed in the record in their entirety. And we would ask that you please limit your oral remarks to 5 minutes.

We have a lighting system when we remember to employ it, which gives you a green light at the beginning of your testimony. When you are 4 minutes into your testimony, it will turn yellow to warn you that you have a minute remaining. And when the yellow light turns red, you know that your time has expired. If we catch you mid-sentence when the light turns red, we would ask that you please just summarize your final thoughts so that we can move on to the next witness.

After each witness has presented his or her testimony, Subcommittee Members will be permitted to ask questions subject to the 5-minute limit.

With that, I would now invite Ms. Wagnon to please proceed with her testimony.

TESTIMONY OF JOAN WAGNON, SECRETARY OF REVENUE, STATE OF KANSAS, TOPEKA, KS, ON BEHALF OF THE STREAMLINED SALES TAX GOVERNING BOARD

Ms. WAGNON. Well, good morning, Chairwoman Sánchez and Chairman Conyers and Ranking Member Cannon, and all of the rest of you Members of the Committee. I do appreciate the opportunity to speak to you today. I am here representing the governing board of the streamlined sales tax. And I do refer to it as SST because it is shorter.

And I want to encourage Congress to recognize that the simplifications that we have achieved in our member States sales taxes are sufficient to remove the burden on interstate commerce that the Supreme Court noted in *Quill v. North Dakota* and sufficiently simplified for Congress to allow the States to require remote retailers to collect our sales tax. That is our goal. That is our work on simplification, and that leads to mandatory collection.

I wanted to make one point today about the nature of——

Ms. SÁNCHEZ. Ms. Wagnon, I am sorry. Can I interrupt you for a moment?

Ms. WAGNON. Yes.

Ms. SÁNCHEZ. We just want to check and make sure that your microphone is on. Otherwise your testimony isn't recorded.

Ms. WAGNON. It says that it is green.

Ms. SÁNCHEZ. Okay.

Ms. WAGNON. Am I not close enough?

Ms. SÁNCHEZ. I suspected as much, I just wanted to verify. And I apologize for interrupting.

Ms. WAGNON. Not a problem. I am just still looking to see my light. So——

Ms. SÁNCHEZ. We will give you additional time and make sure that you finish your statement.

Ms. WAGNON. My first point was that the nature of retail is changing. And I think Congressman Delahunt's statement and Ms. Sánchez's statement have eloquently spoken to that. And I won't go into it again, except to say that our sales tax bases in States across this country are rising maybe at 2 percent a year. And we see the erosion at maybe 27 to 30 percent a year. So that point is so valid.

So let me really give you an update on where we are with SST about our need for simplification. And I am, quite frankly, amazed at the phenomenon that is the streamlined sales tax because you for the first time have seen business stakeholders coming together with tax administrators, legislators, and members of the public to devise solutions to problems that have been huge.

We have a myriad of sales tax laws. You asked why do we need to simplify. Just the number of forms that you fill out in order to report in every State—they are all different. We now have 22 States that are part of the agreement, and they all have a single reporting form done electronically. That in and of itself is simplification.

There is a map in your packet that we have provided that shows you the number of States. Today we have 22. It is my hope that we have 10 more States that we are working with that over the course of the next year if we are able to maintain the progress that we have made so far will be able to join with us.

Twenty-eight percent of the country's population now lives in a streamlined state. The reason those States are not—those 10 are not with us now—we need to make a minor adjustment in our sourcing rules so that some of the barriers that currently exist can be overcome. We have a meeting scheduled in Dallas next week, and we will be discussing those changes.

We made a number of changes in the agreement, as was noted in the opening remarks, because we had not completely finished the work when the agreement was first adopted. But what we have done so far is absolutely amazing. Since December of 2005, we have been able to bring those 22 States onboard, achieve the simplifications that are outlined in the bill. And section 6 of that bill is a wonderful framework for what simplification looks like.

And our annual report does show that just in the last year we brought in almost $89 million for the 2007 fiscal year. So if you compare that to the number that is collected overall, it has been an explosion of collections by these 1,072 sellers that are currently registered.

What does our simplification look like? We have certified service providers that provide services free of charge to remote sellers to collect and distribute these new taxes. So what could be simpler than that?

The payments come from the new money that is being collected. We do have a simplified reporting form used by all States.

In the past it was said there wasn't sufficient software. But that is just not right. The software has been there. What has been missing is the rates and boundaries databases where States will certify these are the rates in all of these different jurisdictions, these are the boundaries.

We do not allow them to change more than once a quarter. We give notice to retailers when it does change. We hold them harmless if we use these States' boundaries and databases. And so, that makes it possible to do the collection.

We have a central registration system that provided amnesty in the first 12 months. And it provides liability protection for people that are enrolling.

We have managed to, I believe, accomplish everything that is in section 6 of the bill where there is a listing of simplification measures with one exception. We have not gotten around to the issues in the dispute resolution process. We have been pretty busy organizing the board. We have taken care of our governance issues. We have come up with a standard uniform product definitions.

The most recent amendment to the agreement was an amendment about digital goods. We had a hard time figuring out what digital goods are going to look like in the future. But we finally have come up with those descriptions.

I think you are going to see fewer amendments in the future, more effort toward bringing in new States. I think you are going to see more effort to work with you in Congress to help you with having information that shows that we have indeed simplified the system and that our voluntary system is bringing in to the best of our ability.

But the question is should it stay voluntary forever. I don't think so. I think we are letting a lot of people off the hook who are operating, as Mr. Delahunt said, at a competitive advantage over the people in your home States because they don't have to collect the sales tax. And that simply isn't fair. So we would ask you to overturn the *Quill* decision, to work with us and give us the ability to collect this tax.

[The prepared statement of Ms. Wagnon follows:]

PREPARED STATEMENT OF JOAN WAGNON

Good Morning Chairwoman Sánchez, Ranking Member Cannon, and Members of the Subcommittee:

Thank you for giving me the opportunity to speak with you today. I am Joan Wagnon, President of the Streamlined Sales Tax Governing Board and Secretary of Revenue for the State of Kansas. I have also served as a state legislator for 12 years, Mayor of Topeka for 4 years and president of Central National Bank in Topeka—all helpful experiences in my current capacity with the Streamlined Sales Tax Governing Board since SST brings together state legislators and state tax administrators with business interests and local governments. It's quite a balancing act for the Board, but we recognize the importance of respecting the partnerships that have been created in this process and continuing to work together.

I am here today representing the Governing Board and wish to urge Congress to recognize that the simplifications we have achieved in our Member State's sales taxes are sufficient to remove the burden on interstate commerce as noted by the Supreme Court in *Quill v. North Dakota*, and sufficiently simplified for Congress to allow states to require remote retailers to collect our sales taxes. That's our goal: simplification and mandatory collection.

My remarks today will attempt to give you some background on Streamlined Sales Tax (SST), why it is important to states as well as the business community, and why the federal legislation is so important to all of us involved in the project.

First, retailing is changing rapidly. So rapidly, that in fact, without the federal legislation allowing states to require remote retailers to collect the sales tax on interstate sales, whether catalog or internet, states will experience an ever-accelerating loss in their sales tax bases. I have attached an article to my testimony, "E-Tailers Launch Holiday Shopping Season" that talks about the "Cyber Monday" and the push for on-line sales. In the article internet retailers are reporting huge surges in sales. One retailer reported *". . . that traffic soared more than 70 percent and sales were up 82 percent as of Monday afternoon. Another reported, ". . . an almost 49 percent increase in sales compared with a year ago, beating expectations for 20 percent growth."*

This continued explosion in growth of online sales is at the expense of the brick and mortar stores in our hometowns. The competitive advantage of shopping without sales tax collection is huge. Most consumers don't remit the compensating use tax which their laws have imposed, so the loss to the states is quite real. And that loss is growing faster than our sales taxes grow. In Kansas, for example, our sales tax collections are flat, and the money coming in from the use tax collected under the voluntary SST program because we are a Streamlined state, is quite necessary to prevent having to raise our taxes which no one wants to do.

Second, I'd like to talk a little about SST, how we got started, how many states are involved, the Agreement which all of us have adopted, and where we are going.

The rise of the Streamlined Sales Tax Project is an amazing phenomenon—45 states voluntarily coming together time after time over a period of several years to create a voluntary system to demonstrate to Congress and business that we can simplify sales taxes. The leadership exerted by the National Conferences of State

Legislatures, the National Governor's Association, the Federation of Tax Administrators, and the Multistate Tax Commission was enormously helpful. The commitment and guidance from the business community was remarkable. They have now formed a Business Advisory Council that meets regularly to advise the Governing Board and have two ex officio members on the Governing Board. In my 20 plus years in government, I've never seen a coalition like this come together and work to solve problems. The result was the Streamlined Sales and Use Tax Agreement (SSUTA) which was adopted by the participating states in November, 2002. States then set about changing and simplifying their tax laws.

WHO BELONGS TO THE STREAMLINED SALES TAX GOVERNING BOARD?

The Governing Board was formed pursuant to the Streamlined Sales and Use Tax Agreement (SSUTA) on October 1, 2005 by thirteen states which were in full compliance with the SSUTA, representing 20.3 percent of the population of all the sales tax states. This accomplishment is unparalled in government history. Certainly we've had compacts before, and model legislation, but nothing like SST. Five associate states joined with those thirteen full member states making a total of 18 states involved since the beginning. An additional four states have joined the Streamlined Sales Tax Governing Board since its founding bringing the number today to 22.

I would encourage you to examine the attached map and listing that shows the status of states. On January 1, 2008 Associate Members Arkansas and Wyoming will become full members. Washington will become a full member on July 1, 2008. Nevada's petition for full membership will be considered at our Governing Board meeting next week in Dallas. These states either had future effective dates in their legislation, or had to rework some part of their law to pass the stringent review by the Compliance and Interpretations Committee and the full Governing Board. The review is indeed, stringent, and some states didn't make it the first time! It requires a 3/4 vote to be admitted and certified that your state's laws are simplified in accordance with the Streamlined Sales and Use Tax Agreement. Once certified, each state has to recertify annually that it didn't change its laws and come out of compliance. We take compliance seriously!

Over 28 percent of the country's population now lives in a Streamlined state. We are in constant communication with the other states that support Streamlined, but haven't yet simplified all their laws. We call them Adviser states, and they participate substantively in the State and Local Advisory Council, and on the governing board in a limited way as they continue to try to amend their laws in order to join with us. I believe there are another 10 states that are likely to join in the next two years if we can continue the progress we have made so far. Some states are waiting to see if there is movement in Congress, so this hearing is particularly encouraging for them. Others need a modification in our sourcing rule which will be discussed at the meeting in Dallas next week.

HOW MUCH MONEY HAS BEEN COLLECTED?

Our Annual Report which is attached notes several successes in this past fiscal year. One of the greatest is the amount of tax collected by the sellers who have registered on the Streamlined registration system. The sellers registered on the Governing Board's registration system collect sales taxes for the member states. Member states report that those **sellers who registered voluntarily to conduct business in their states collected $88,958,093 in sales tax for the 2007 fiscal year.** This represents tax that was owed but would otherwise not have been collected or paid to those states.

HAS THE SYSTEM BEEN SIMPLIFIED? ABSOLUTELY!

These collections were made possible, in part, because the Governing Board contracted with three **Certified Service Providers** to provide services, free of charge, to remote sellers to collect and distribute these sales taxes. What could be simpler? The payments to these CSP's come from the new money that is collected. A fourth company is in the process of being certified. All reporting is electronic on a simplified reporting form used by all states. The development of this single form and the ability to transmit electronically is a huge accomplishment and simplification.

A **Rates and Boundaries data base,** provided by each member state, ensures that the monies collected go to the appropriate jurisdiction, and CSP's and retailer are held harmless if they use these state tools and they inaccurately distribute the funds. In the past, concerns have been raised to this Subcommittee about the existence of software to handle this tax collection function. While software has been available for a number of years, what was missing was the accurate information about tax rates and district boundaries. These Rates and Boundaries data bases make it possible to collect taxes at the destination of the goods and services.

The Governing Board maintains a web site with a **central registration system,** making it easy for these remote retailers to register, and also provided amnesty during the first 12 months in order to encourage retailers to register. Every effort is made to balance the burden, relieve sellers of responsibility when the state doesn't function or makes an error, and to work electronically.

As of November 28, 2007 there were 1,072 companies registered on the Governing Board's centralized registration system. The system asks sellers to choose a "model" which indicates whether the seller will utilize the services of a certified service provider or a certified automated system (CAS) or will file and pay their sales tax using their own system. One hundred nine of the registered sellers stated they were using a CSP, 53 said they would use a CAS, and 910 said they would use their own system to collect and report sales tax to the member states. These sellers range in size from the very large to the very small pure internet sellers.

The Agreement, itself, has been modified regularly since it was first signed, largely to embrace issues, such as the handling of digital products, which were not included in the original agreement. The basic simplification requirements remain unchanged; however some issues just simply needed more discussion and those have been the subject of the amendments. It is envisioned that changes in the future will be fewer and much further between since the large number of unresolved issues has now been addressed. Although a few contentions issues are still on the Dallas meeting agenda, it is expected that the Governing Board will turn its attention to trying to recruit more states, and become more active with the federal legislation.

Other simplification has been achieved in the form of a **single, simplified report form, electronic registration and reporting, uniform product definitions, availability of a certified service provider for collecting and reporting to the states, uniform sourcing and rounding rules, elimination of caps and thresholds, state administration, consistency between local and state tax bases,** and a host of other things, most of which are included in your legislation, H.R. 3396, section 6. Although the Governing Board has not formally compared the Agreement to this particular piece of legislation, Mr. Scott Peterson, our Executive Director and I agree that all the requirement of that section are in place now, with the exception of the rules and regulations for dispute resolution, which fortunately, we have not needed to date. Those are on our list to accomplish in the near future.

WHAT'S NEXT?

There are still a few issues to resolve and they are being worked on in the State and Local Advisory Committee and will reach the Governing Board this year, some as early as December 11, 2007 in Dallas.

- A review of the direct mail and delivery definitions and rules.
- A review of the replacement taxes definition.
- A review of the rule on software maintenance contracts.
- A review of the florist sourcing issue paper.
- A review of the Energy Star products definition for sales tax holidays.
- A review of the sales price/sale for resale definitions.

The biggest issue is to expand the sourcing rule, while retaining uniformity, to allow for origin sourcing in-state for those states that have been unable to convert totally to destination sourcing. (The current rule says that the source of a sale, i.e., where the tax is applied, is where the goods are delivered, not where the sale originated. About half of the states use origin sourcing—where the sale was made—as the place where the tax is applied. This is quite a change for certain businesses, such as furniture stores, pizza delivery places, etc.) Texas, Ohio, Tennessee, Utah, Virginia, Illinois, New Mexico, Missouri have all been participating in the refinement of the current rule as well as members of the Business Advisory Council. Several alternatives are on the table for discussion in Dallas next week.

The SST Executive Committee, officers and I will be approaching other states that are interested in becoming member states to see if we can assist them. Scott Peterson and I have visited with the tax reform commissions in Massachusetts, and Connecticut. There is interest in both states. Several southern states are also interested and we plan to visit them in the coming months to assess their interest and potential participation.

Finally, with regard to H.R. 3396, the Governing Board stands ready to work with this Subcommittee as you mark up the bill and try to resolve the remaining outstanding issues. The important thing to remember, however, is that the basic framework of the bill mirrors the current Streamlined Sales and Use Tax Agreement. The provisions in Section 6 are included in the Agreement as it exists today. We have met and exceeded the threshold provisions for numbers of states, and percent of population. The Governing Board is operating smoothly, has excellent staff, and can continue to expand as required. We are in the process now of analyzing what changes we might have to make to conform to the legislation as written, or any suggested changes when you mark up the bill.

On behalf of the Governing Board, I urge you give states the ability to require remote sellers to collect our sales tax and use the authority to overturn Quill that the Supreme Court acknowledged Congress has. Please pass H.R. 3396.

Attachment #1

E-Tailers Launch Holiday Shopping Season

By ANNE D'INNOCENZIO Tuesday, November 27, 2007

NEW YORK - After a long weekend of battling maddening crowds at the malls, the last thing most people want to do is go back to the stores after work to do more shopping.

To make it easier for the bruised, battered and otherwise shopped-out, retailers kicked off the official start to the online season, dubbed "Cyber Monday," with lots of come-ons to keep the cash registers ringing even as consumers return to work.

With an overall holiday season that is expected to be the weakest since 2002, and the number of new online customers leveling off, Web retailers are dangling even more incentives to keep them buying online, from fat discounts to free shipping without minimums.

On Monday, Wal-Mart Stores Inc. launched five days of specials only available at Walmart.com. The 150 online specials this week is triple the number that was offered a year ago and include $60 quartz cocktail rings and $1,198 Samsung 40-inch LCD HDTVs. Toys "R" Us Inc. held a one-day online sale, and rival eToys.com launched a two-day sale.

"More and more retailers are using Cyber Monday as a promotional event," said Andrew Lipsman, senior analyst at comScore Networks Inc., an Internet research firm.

Target Corp., Circuit City Stores Inc., Sears Holdings Corp., Crate & Barrel, the Discovery Store and Overstock.com Inc. were among dozens of retailers offering free shipping Monday.

The incentives seemed to work, with many sites reporting surges in traffic that at least met expectations. Ice.com, an online jewelry site that offered 20-percent-off coupons, reported that traffic soared more than 70 percent and sales were up 82 percent as of Monday afternoon. Ice's CEO, Shmuel Gniwisch, had projected a 65 percent gain in business. Ebags.com, which offered a 20 percent discount on merchandise Monday, reported an almost 49 percent increase in sales compared with a year ago, beating expectations for 20 percent growth.

Raul Vazquez, chief executive of Walmart.com, expected 7 million visits to the site Monday, up from more than 5.5 million a year ago. As of mid-afternoon, plenty of items had already sold out, including $448 1-carat diamond earrings, $38 toy workbenches from Step2, and $10 Thomas the Tank Engine toys.

There were some snags. The heavy traffic overwhelmed an e-commerce service offered by Yahoo

Inc., preventing consumers from completing purchases at thousands of Web sites Monday. The outages began late in the morning on the East Coast and continued for at least four more hours, Yahoo spokeswoman Kristen Wareham said.

The problems affected more than half of the roughly 40,000 sites that subscribe to Yahoo's "merchant solutions" service, which costs $39.95 per month plus a 1.5 percent sales commission.

While the first Monday after Thanksgiving kicks off the online holiday shopping season, it's not the busiest day for retailers, according to comScore. Last year, the busiest online shopping day was Wednesday, Dec. 13, generating $667 million in sales. The Monday after Thanksgiving was actually the 12th busiest day in terms of sales for the 2006 holiday season.

Still, Ellen Davis, a spokeswoman for The National Retail Federation, which coined the term "Cyber Monday," noted that even though more than half of U.S. homes now have high-speed Internet access, a growing number of office workers feel more comfortable shopping online at work. This year, according to a survey conducted for Shop.org, the online arm of the NRF, 54.5 percent of office workers with Internet access, or 68.5 million people, are expected to shop for holiday gifts from work, up substantially from 50.7 percent in 2006 and 44.7 percent in 2005.

Davis noted one reason is that consumers feel they have more privacy shopping from the office rather than from home.

Last year, NRF launched CyberMonday.com, which pulls together online discounts not just for Cyber Monday but for the entire holiday season. As of Monday afternoon, the site had 1 million visits, three times the number a year ago, according to Mall Networks, which powers the site.

ComScore estimated online sales would exceed $700 million Monday. That online surge follows a strong start to the holiday shopping season for brick-and-mortar stores over the weekend, but analysts still fear that the holiday season will be the weakest in five years as shoppers struggle with higher gas and food prices and a slumping housing market.

The research firm Forrester Research predicts online sales of $33 billion this holiday season, up 21 percent from a year ago. That's a slightly slower growth rate than the 23 percent seen last year. ComScore projects a 20 percent online sales growth for the holiday season.

Helen Malani, shopping expert for Shopzilla.com, a search site, said she believes more people will shift their purchases online because of hidden costs associated with shopping at brick-and-mortar stores, like parking fees and eating out. Shoppers are more sensitive to these hidden costs at a time when they are shelling out more money for food and gas, she said.

Still, online executives noted some encouraging signs about consumer spending behavior Monday, even in a challenging economy.

Walmart.com's Vazquez said sales were strong across all price points and categories.

Peter Cobb, co-founder of eBags.com, reported that the average purchase is now $87, up from $75 last year.

Gniwisch of ice.com, which operates ice.com and diamond.com, said averge orders have increased 15 percent for both Web sites. Ice.com's average order has increased to $233 from about $200 a year ago.

Josh Silverman, general manager of shopping portal Shopping.com, said less than 25 percent of shoppers are searching for the cheapest item.

"People are not shopping only by price," he said. "They are looking for the best value."

AP Business Writer Michael Liedtke in San Francisco contributed to this report.

A service of the Associated Press (AP)

Attachment #2

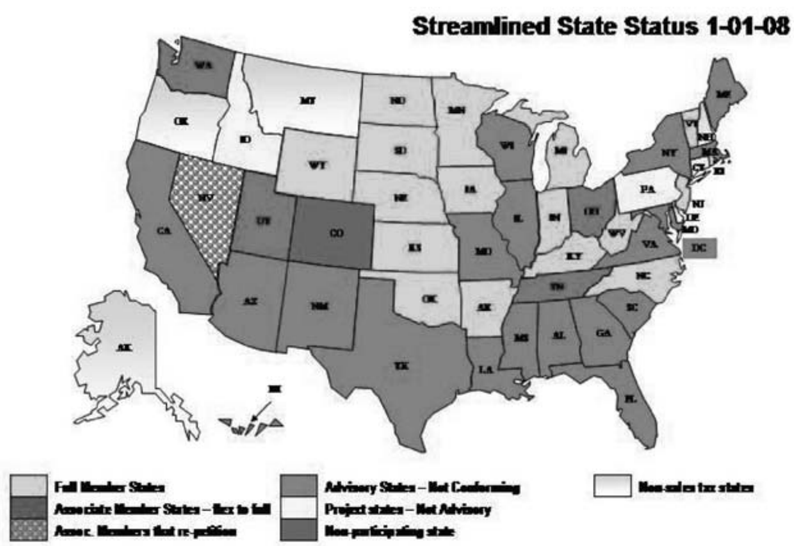
Governing Board States

SST State Status Map

States	Membership
Full Members Indiana Iowa Kansas Kentucky Michigan Minnesota Nebraska New Jersey North Carolina North Dakota Oklahoma Rhode Island South Dakota Vermont West Virginia	A **full member state** is a state that is in compliance with the Streamlined Sales and Use Tax Agreement through its laws, rules, regulations, and policies.
Associate Members Arkansas Nevada Ohio Tennessee Utah Washington Wyoming	An **associate member state** is either (a) a state that is in compliance with the Streamlined Sales and Use Tax Agreement except that its laws, rules regulations and policies to bring the state into compliance are not in effect but are scheduled to take effect on or before January 1, 2008, or (b) a State that has achieved substantial compliance with the terms of the Streamlined Sales and Use Tax Agreement taken as a whole, but not necessarily each provision, and there is an expectation that the state will achieve compliance by January 1, 2008.

Attachment #3

Streamlined States, as of 1/1/08



Attachment #4

Message from President Dwight Cook:

As I sign off on this annual report I would be remiss if I didn't thank all of you who worked so hard to make our efforts such a success. The commitment, dedication and professionalism shown by all of you is absolutely amazing. You have addressed our challenges in this public policy arena in no less a manner than the American public would expect. I believe this annual report shows a level of accomplishments that none of us dared to think possible after just two years. We still have many challenges yet to address yet I am confident that they too will be put to rest. I look forward to the passing of the Federal legislation and the continued growth in state membership. The road to perfection is still under construction but the ride should soon start becoming a lot smoother.

Introduction:

On October 1, 2005, thirteen states representing 20.3 percent of the population of all the states with a sales tax joined together to activate the Streamlined Sales and Use Tax Agreement. Five associate states joined with those thirteen full member states.

Four states have joined the Streamlined Sales Tax Governing Board since its founding. In the 2007 fiscal year Rhode Island, Vermont and Washington became members. Over 28 percent of the country's population lives in a member state.

There have been several successes in this fiscal year. One of the greatest is the amount of tax collected by the sellers who have registered on the Streamline registration system. The sellers registered on the Governing Board's registration system collect sales taxes for the member states. The member states report that those sellers who were not already registered to conduct business in their states collected $88,958,093 in sales tax for the 2007 fiscal year. This represents tax that was owed but would otherwise not have been collected or paid to those states.

Member States:

Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, North Carolina, North Dakota, Nebraska, New Jersey, Oklahoma, Rhode Island, South Dakota, Vermont, West Virginia

Associate Member States:

Arkansas, Nevada, Ohio, Tennessee, Utah, Washington, Wyoming

Changes to the Streamlined Sales and Use Tax Agreement:

The Governing Board approved the following changes:

- Required state to provide boundary databases at least 30 days in advance of a calendar quarter.
- Delayed when florists must transition to destination sourcing.
- Repealed the multiple points of use provisions.
- Provided additional liability relief for purchasers who rely on state provided data.
- Imposed additional requirements on states to review and certify accuracy of CSP systems.
- Conferred advisor states status on those states that were implementing states.

- Changed how a state becomes an associate member.
- Separated Governing Board rules into procedural rules and interpretive rules.
- Clarified how long states have to comply with changes in the Agreement.
- Revised the definition of durable medical equipment.

Officers:

President
Senator Dwight Cook
North Dakota State Senate

1st Vice President
Joan Wagnon, Secretary
Kansas Department of Revenue

2nd Vice President
Delegate John Doyle
West Virginia House of Delegates

Secretary/Treasurer
Robert Cox
Kentucky

Directors:

Senator Luke Kenley
Indiana State Senate

Senator Ron Amstutz
Ohio State Senate

Jerry Johnson, Commissioner
Oklahoma Tax Commission

R. Bruce Johnson, Commissioner
Utah State Tax Commission

Loren Chumley, Commissioner
Tennessee Department of Revenue
(1st half of year)

Andy Sabol
North Carolina
(2nd half of year)

Nominating Committee:

Senator Dwight Cook, Chair
North Dakota

Tom Atchley
Arkansas

Senator Luke Kenley
Indiana

Richard Dobson
Kentucky

Dale Vettel
Michigan

Representative Paul Dennert
South Dakota

Representative Mark Maddox
Tennessee

Representative David Drovdal
North Dakota

Finance Committee:

Robert Cox, Chair
Kentucky

David Casey
Iowa

Representative Rodney Anderson
Wyoming

Senator Janis Lee
Kansas State Senate

Senator Jim Hill
Arkansas State Senate

Compliance Review and Interpretations Committee:

Larry Wilkie, Chair
Minnesota

Joseph VanDevender
Indiana

Michigan

Andy Sabol
North Carolina

Myles Vosberg
North Dakota

Tony Mastin
Oklahoma

Dan Noble
Wyoming (1st half of year)

Delegate John Doyle
West Virginia (2nd half of year)

Oklahoma

Issue Resolution Committee:

Senator Mac McCracken, Chair
South Dakota

Mary Cameron
Arkansas

Richard Dobson
Kentucky

Craig Rook
New Jersey

Virgil Helton
West Virginia

Staff Changes:

In the 2007 fiscal year the Governing Board added two additional staff. David Thompson serves as the technology specialist and Jessica Ando serves as the executive assistant.

FY2007 Financial Report:

To end FY 2007, the Governing Board realized a surplus for the budget period of $279,108. This resulted in an ending balance of accumulated receipts in excess of expenditures of $640,336. Receipts totaled $902,197 and came from the petition fees paid by full and associate member states ($604,000), gross revenue generated from Streamlined meetings ($268,575), and interest income ($29,622). Expenses were below budgeted levels by $225,411, and revenues were $6,197 more than budgeted levels. Salaries and benefits, office expenses, travel expenses, and contractual expenses were all lower than anticipated. Salary and benefits were lower due to delays in completing the hiring process. Compared to the previous fiscal year, expenses were up by 33 percent, while revenues rose 48 percent. Major budgetary developments in FY 2007 include:

- Employment of two additional full time employees as anticipated in budget.
- Rental of office space and purchase of furniture and equipment.
- Write-off of uncollectible accounts receivable accumulated in past fiscal years.
- Significantly lower expenditures for web site development, travel,

insurance expenses, and other contractual services compared to budgeted levels.

To begin FY 2007, the organization held $369,105 in cash. Due principally to the operating surplus, the ending cash balance rose to $855,770. A portion of the increase in cash represents accounts payable and prepaid FY08 dues from several member states.

At the end of FY 2007, assets of the Governing Board totaled $933,879, of which 92 percent was held in the form of cash or cash equivalents. Much of the remainder was composed of accounts receivable, with minor portions representing furniture and equipment, prepaid expenses, and rental deposit.

The financial assets of the Governing Board are held in an Advantage Interest Checking account with Wachovia. This type of account is suitable for large non-profit organizations like the Governing Board, and earns competitive interest on balances above those needed to offset monthly service charges. Interest earned on this account totaled $29,622 in FY07. As of June 30, bank statements received by the Governing Board have been reconciled with accounts maintained by the Governing Board.

The following financial statements include the balance sheet as of June 30, 2007; a historical presentation of the Income and Expense Statements from FY 2003 through FY 2007; the variance between Budgeted and Actual Receipts and Expenditures for FY 2007, a cash flow statement for FY 2007; and detailed breakdown of accounts payable and receivable.

The documents reflect a strong and stable financial condition after two years of operation under the Governing Board.

Streamlined Sales Tax Governing Board
FY 2007 Annual Report of Receipts and Expenses

	FY 2003 Actual	FY 2004 Actual	FY 2005 Actual	FY 2006 Actual	FY 2007 Actual
BEGINNING BALANCE	$ 31,138	$ 50,514	$ 57,306	$ 220,482	$ 361,228
INCOME					
Member Payments	$ -	$ -	$ 80,000	$ 300,000	$ 604,000
Member Payments held in escrow	$ -	$ -	$ -	$ -	$ -
Publication Sales	$ -	$ -	$ -	$ -	$ -
Investment Income	$ -	$ -	$ -	$ 7,048	$ 29,622
NGA/NCSL Contributions	$ -	$ -	$ 100,000	$ -	$ -
Meeting Income	$ 155,700	$ 152,265	$ 260,950	$ 302,650	$ 268,575
TOTAL INCOME	**$ 155,700**	**$ 152,265**	**$ 440,950**	**$ 609,698**	**$ 902,197**
EXPENSES					
Salaries and Benefits					
Salaries	$ -	$ -	$ -	$ 60,096	$ 212,306
Payroll Taxes	$ -	$ -	$ -	$ 8,589	$ 17,814
Health coverage	$ -	$ -	$ -	$ 1,783	$ 7,243
Retirement Expense	$ -	$ -	$ -	$ -	$ 150
Subtotal- Salaries	$ -	$ -	$ -	$ 70,468	$ 237,513
Office Expense					
Telecommunications	$ 7,650	$ 8,209	$ 21,461	$ 24,621	$ 15,150
Printing	$ 3,666	$ 1,248	$ 7,140	$ 24,372	$ 6,856
Materials and Supplies	$ 1,821	$ -	$ 432	$ 87	$ 4,191
Postage and Delivery	$ 830	$ 148	$ 2,279	$ 676	$ 1,902
Law Service and Books	$ -	$ -	$ -	$ 743	$ 1,147
Computer Equip. & Furniture-Depreciation	$ -	$ -	$ -	$ -	$ 3,347
Computer Equipment and Furniture	$ -	$ -	$ -	$ -	$ 5,355
Other Insurance	$ -	$ -	$ -	$ -	$ -
Other	$ 5,371	$ 5,123	$ 24,040	$ 847	$ 7,855
Subtotal-Office Expense	$ 19,338	$ 14,729	$ 55,352	$ 51,346	$ 45,804
Travel					
Employee Travel	$ -	$ -	$ -	$ 31,867	$ 29,180
Other Travel	$ 2,664	$ 3,176	$ 18,676	$ 7,687	$ 3,891
Subtotal- Travel	$ 2,664	$ 3,176	$ 18,676	$ 39,554	$ 33,071
Contractual Services					
Rent - Office Space	$ -	$ -	$ -	$ -	$ 8,287
Central registration	$ -	$ -	$ -	$ 72,938	$ 52,594
Accounting services	$ -	$ -	$ -	$ 1,050	$ 11,400
Legal Services	$ -	$ -	$ -	$ 9,850	$ 11,050
Fund audit	$ -	$ -	$ -	$ -	$ 9,000
Web Site Development and Hosting	$ -	$ -	$ -	$ -	$ 540
Other	$ 14,555	$ -	$ -	$ 20,890	$ 5,429
Subtotal - Cont. Svcs.	$ 14,555	$ -	$ -	$ 104,728	$ 98,299
Meeting Expenses	$ 99,768	$ 127,567	$ 203,745	$ 202,855	$ 208,402
Reserve	$ -	$ -	$ -	$ -	$ -
TOTAL EXPENSES	**$ 136,325**	**$ 145,472**	$ 277,774	**$ 468,951**	**$ 623,089**
Surplus/Deficit for Budget Period	**$ 19,375**	**$ 6,793**	**$ 163,176**	**$ 140,747**	**$ 279,108**
ENDING BALANCE	**$ 50,514**	**$ 57,306**	**$ 220,482**	**$ 361,228**	**$ 640,336**

Audit Committee Report:

SST Audit Committee Accomplishments for the past year:

1.) The Audit Committee created the Audit Core Team concept for audits of certified service providers (CSPs) and Model 1 sellers. The Audit Core Team was approved by the Governing Board Executive Committee October 2006. The Audit Core Team includes auditors from Indiana, Minnesota, Oklahoma and West Virginia. The Audit Core Team will conduct the contract compliance audit of each CSP and assist full member states with tax compliance audits of CSPs and Model 1 Sellers.

2.) From past issue papers the Audit Committee prepared Rule 806.3 Administration of Compliance Audit Process and submitted to the SST Governing Board for approval at the June 2007 meeting. The audit rule provides the basis for contact compliance audits and tax compliance audits of CSPs and Model 1 Sellers.

3.) The Audit Committee developed questionnaires for CSPs, member states and the Executive Director to be used in the audit process of CSPs.

4.) July 19, 2007 The Audit Committee held a one day training session to train state audit personnel on their responsibilities for audits of CSPs and Model 1 Sellers. The Audit Committee created and organized the training materials for this class.

5.) The Audit Committee developed audit plans and created a timeline for audits of CSPs and Model 1 Sellers.

6.) The Audit Committee established procedures for statistical sampling including identifying attributes to test and established maximum tolerable error for Streamlined Sales Tax audits.

7.) The Audit Committee continues to work on an audit manual by assigning topics to committee members and reviewing drafts at committee meetings to get a consensus of the committee.

Certification Committee Report:

The Certification Committee, in accordance with procedure, has routinely monitored and evaluated the ongoing performance of the Certified Service Providers while working to ensure that the Member States achieve and maintain operational compliance. This past year, much attention has been given to the state provided rate and boundary databases to address issues to maintain accuracy, stability and availability. The Committee proposed the Kansas sponsored amendment to the SSUTA that requires the databases be available 30 days prior to the beginning of a calendar quarter and to make them accessible from a centralized location. The databases are available for download from a central site that is being provided and maintained by Testing Central.

The Certification Committee also developed a process that provides assistance, information and instruction to petitioning states to ensure operational compliance at their time of acceptance as a member state. Washington is the latest state to utilize this procedure and, as an active member of the

Committee, is helping to refine and enhance the process.

In May, Certification Committee members met with representatives from the Audit Committee to address roles and responsibilities for contract compliance and recertification of the CSP's. An immediate result of the meeting was the apparent need to address the unfinished Audit Work Site paper, otherwise known as Appendix F in Article V of the Rules and Procedures of the Governing Board. After discussion with Audit and CSP representatives, it was decided that the transactional data required for compliance and tax audits would be better provided through download capabilities from a secure FTP site instead of a web-based administrative site. The Certification Committee and Testing Central finalized the file transfer and data requirements in Appendix F that related to the Audit process. Testing Central provides and maintains the FTP site.

In accordance with Section 305 (H) of the SSUTA, two vendors have applied for certification of their boundary databases. The Committee has met with the vendor representatives for product review and to discuss possible procedures for certification. This work is ongoing. One vendor has made application to be a Certified Service Provider and the Committee plans to conduct the site assessment and evaluation process in November. Three vendors have made application as Model 2 CAS providers, one of which is actively preparing to begin the evaluation process.

Compliance Review and Interpretations Committee Report:

The membership of the Compliance Review and Interpretations Committee (CRIC) changed when Dan Noble from Wyoming resigned and West Virginia Delegate John Doyle was appointed to the position. Current members include Larry Wilkie (Chair), Dale Vettel (Vice Chair), Delegate John Doyle, Andy Sabol, Myles Vosberg, Joe VanDevender and Tony Mastin.

The State and Local Advisory Council submitted five rules to CRIC for review, all of which were sent on to the Governing Board with a recommendation for approval and were subsequently adopted. Petitions for membership from Vermont, Rhode Island and Washington were reviewed, and recommendations to approve the petitions sent to the Governing Board. In addition, CRIC worked on rules relating to administrative procedures of the Committee. Rule 902.1, Interpretive Rules, and Rule 904, Compliance Petitions, were drafted and have been adopted by the Governing Board. The Committee is in the process of drafting a rule on annual certification of member states.

Over this past year CRIC reviewed 13 interpretations requests. However, six of those requests were either withdrawn, put on hold, or referred to SLAC for additional work. Recommendations for five of the requests were approved by the Governing Board and two recommendations were submitted to the Governing Board to be discussed at the September 2007 meeting (see list below).

Approved Interpretation Recommendations:

- 2006-08, South Dakota request pertaining to amnesty.
- 2006-09, Ernst & Young, LLP request pertaining to amnesty.

- 2006-11, Rhode Island request pertaining to the definition of "bulk servings" as used in the definition of "prepared food."
- 2006-12, McCarter & English, LLP request pertaining to the definition of "direct mail."
- 2007-01, Avalara request concerning the definition of "drug."

Interpretation Recommendations submitted for the September Governing Board meeting:

- 2007-02, Lafarge North America request concerning sourcing.
- 2007-03, General Nutrition Centers, Inc. request pertaining to the definition of "flour" as used in the definition of "candy."

State and Local Advisory Council Report:

The State and Local Advisory Council completed the following assignments:

- The analysis and resolution of the discussion on bundling, including adoption of Rule 330, Bundled Transactions.
- The analysis and drafting of multiple points of use sourcing by repeal of Section 312 of the Agreement and adoption of Rule 309. This rule deals with sourcing of prewritten computer software, computer-related services, and software support agreements.
- The analysis and drafting of Rule 327.3, Healthcare Definitions, which categorizes different types of health care equipment into the Agreement health care definitions.
- Drafting rules on issue papers on the following:
    - Telecommunications definitions Rule 327.2
    - Telecommunications sourcing Rule 314
    - Administration of Exemptions Rule 317
    - Drop Shipments Rule 317.2
- The analysis and drafting of data elements for the information report.
- The analysis and drafting of the definition of fur clothing and the fur clothing interpretation request.
- The analysis and drafting of purchaser liability Section 331.
- The analysis of the prepared food (food sold with eating utensils provided by the seller) interpretation.
- The analysis of the florist sourcing amendment.
- The analysis of the revised certificate of compliance document.

The State and Local Advisory Council has the following in progress:

- A review of the digital products definitions and interpretive rule.
- A review of the direct mail and delivery definitions and rules.
- A review of the replacement taxes definition.
- A review of the rule on software maintenance contracts.
- A review of the florist sourcing issue paper.
- A review of the Energy Star products definition for sales tax holidays.
- A review of the sales price/sale for resale definitions.

Business Advisory Council Report:

The Business Advisory Council (BAC) is a separate 501(c) organization which was established to represent the views of the business community in meetings of the Governing Board and the State and Local Advisory Council. The BAC membership includes approximately 600 company representatives from every industry segment and business size. For the fiscal year ending in 2007 the President of the BAC was Warren Townsend, Wal-Mart Stores. The Chair and Vice-Chair of the BAC Liaison Committee are Stephen Kranz, Council On State Taxation, and Rich Prem, Amazon.com, respectively. The BAC advocates for reduction of administrative burden and elimination of audit risk.

Registered Sellers:

As of the end of the fiscal year there were 1,017 companies registered on the Governing Board's centralized registration system. The system asks sellers to choose a "model" which indicates whether the seller will utilize the services of a certified service provider or a certified automated system (CAS) or will file and pay their sales tax using their own system. Ninety of the registered sellers stated they were using a CSP, 57 said they would use a CAS, and 870 said they would use their own system to collect and report sales tax to the member states. Since the end of the fiscal year the number of registered sellers has increased to 1,051.

Ms. SÁNCHEZ. Thank you, Ms. Wagnon. Your time has expired. And I am told that the lights are actually not working.

Ms. WAGNON. They are not working. I had no idea where I was.

Ms. SÁNCHEZ. We are employing them, they just aren't working. So we are resorting to good, old fashioned ingenuity. We will let you know when you have 3 minutes remaining and when you have 1 minute remaining. We do have the timer up here. So thank you for bearing with us.

Okay, we just roll with the punches. What can I say?

I want to thank you for your testimony.

And I want to invite Mr. Zakrzewski to please proceed with his testimony.

TESTIMONY OF WAYNE ZAKRZEWSKI, ESQUIRE, VICE PRESIDENT, ASSOCIATE GENERAL COUNSEL—TAX, J.C. PENNEY CORPORATION, INC., DALLAS, TX, ON BEHALF OF THE NATIONAL RETAIL FEDERATION

Mr. ZAKRZEWSKI. Thank you, Chairwoman Sánchez, Chairman Conyers, Ranking Member Cannon, and Members of the Committee. We appreciate the opportunity to talk with you this morning.

I am Wayne Zakrzewski. I am vice president and associate general counsel for tax for JCPenney. I am here to talk to you on behalf of JCPenney and our trade association, the National Retail Federation to speak in support of Mr. Delahunt's bill, 3396. And both on behalf of Penney and the National Retail Federation we urge your support for this important piece of business legislation.

As a representative of JCPenney, I have been involved with the streamlined sales tax project since its beginning. I currently serve as a member of the board of directors of the business advisory council to the governing board and as co-chair to the steering committee for the joint cost and collection study.

JCPenney is a multi-state retailer. We have got $20 billion in sales. And those sales occur through both our stores, catalogue, and an Internet business. Our Internet site is one of the top largest Internet sites for selling apparel and home furnishings.

And to give you a picture of how that business is growing, in 2002, we had $400 million in sales through our Internet business. This year we should hit $1.4 billion. In that short period of time, that business has grown by three-fold. True, some of that business is moving customers from the catalogue to the Internet, but this represents a remarkable growth in the Internet marketplace, which has got to be paid attention to.

So we are here to ask you today to level the playing field between sellers like JCPenney who are required to collect tax because we have physical stores and those people who exploit the marketplace in your States virtually rather than through physical presence. We remit $1.2 billion in sales tax each year. And that $1.2 billion that we collect and our competitors don't give them a competitive advantage, not because they provide innovation or value to the customer, but because they are not required to collect sales tax.

We believe there are compelling reasons that you should act now to allow the streamlined States to require collection. Primary among those is the simplification and uniformity the streamlined agreement has provided and Chairman Wagnon has just described to you. We believe, though, that—we commend them for this effort, but we believe a lot more States would participate if they were rewarded for this difficult effort by having the ability to require remote sellers to collect the tax that is due from their customers.

We support this bill because we believe it would strengthen the streamlined agreement by mandating, by mandating that certain levels of uniformity and sophistication and simplification be maintained and providing an enforcement mechanism to ensure compliance. In the past there has been a major stumbling block to you all acting on this proposal. And that is the concern that collection places on businesses, particularly small businesses.

That burden is illustrated by the results of the cost of collection study that I chaired. That study was conducted by a group of businesses and government organizations interested in streamlining who wanted to measure the cost that collecting would place on business. The result of this study showed that over all businesses the cost of collection under the current system was 3.09 percent of the sales tax collected.

If you break that down by business size, for major—for large businesses with sales over $10 billion, that cost was 2.17 percent. For mid-sized businesses, it was 5.2. And for small businesses, it was 13.4 percent.

This demonstrates that there is a significant burden on all businesses and that it is significantly more for small businesses. We believe, though, that the right way to relieve that burden is not necessarily through a small business exception, but to provide for reimbursement for all businesses based on this cost of collection study.

Rather than having to draw a single line between all business, if you provide for reimbursement, it is a fair system. It also eliminates the burden generally on interstate commerce by providing for reimbursement to all sellers. And it takes care of that burden by removing it through compensation. So again, we would like to urge you to support this and think about this as an alternative.

[The prepared statement of Mr. Zakrzewski follows:]

PREPARED STATEMENT OF WAYNE ZAKRZEWSKI

National Retail Federation
The Voice of Retail Worldwide

Testimony of the National Retail Federation And J. C. Penney Corporation, Inc.

By Wayne Zakrzewski, Esq.
Vice President and Associate General Counsel - Tax
J. C. Penney Corporation, Inc.

Before the
United States House of Representatives
Judiciary Subcommittee on
Commercial and Administrative Law
H.R. 3396: Sales Tax Fairness and Simplification Act of 2007
Room 2237
Rayburn House Office Building
December 6, 2007
10:00 A.M.

Good morning Chairwoman Sanchez, Ranking Member Cannon and members of the Committee. My name is Wayne Zakrzewski, and I am the Vice President and Associate General Counsel for Tax for J. C. Penney Corporation, Inc. ("JCPenney") Today I am here to testify in favor of Mr. Delahunt's bill, H.R. 3396, the Sales and Use Tax Fairness Act of 2007, both on behalf of JCPenney and our national trade association, the National Retail Federation together, we urge swift action by this subcommittee to pass this important retail business legislation.

As a representative of JCPenney, I have been an active participant in the Streamlined Sales Tax ("SST") Project since it began nearly eight years ago in early 2000. I currently serve as a member of the Board of Directors of the Business Advisory Council ("BAC") to the Governing Board of the Streamlined Sales Tax Agreement. I also serve as co-chair of the Steering Committee for the Joint Cost of Collection Study ("JCCS").

JCPenney is a multi-state retailer with $20 billion in annual sales made through our stores, direct mail catalog and Internet businesses. Since 2002 our total business has grown from about $17 billion to $20 billion and we are now one of the largest apparel and home furnishing sites on the Internet. While our catalog business has declined by about $0.7 billion dollars since the 2002 level of $1.8 billion, **our Internet business has grown from $400 million to over $1.4 billion dollars –over a three fold increase**. Some of the Internet growth is due in part to a shift from customers who used to shop through a catalog, but it also represents significant growth in the Internet marketplace.

We are here to ask you to level the playing field between sellers that collect sales tax and those who cannot be required to collect the tax because they do business in the community on a virtual rather than physical basis. We remit over $1.2 billion dollars in sales tax annually on our sales whether made through stores, catalog or online. Many of our online competitors do not collect, which gives them a competitive advantage. This is not because they are innovative or provide incremental value to the consumer, but because the states do not have the ability to require collection of a tax that is due from the consumer.

Their competitive advantage exists because the United States Supreme Court has ruled that businesses that are physically present in a state may be required to collect, while sellers who do business in states only on a virtual basis are not required to collect. The Court found that state sales and use tax systems were too complex to justify placing the burden of collection on sellers that were not physically doing business in a state. However, the current system not only places local businesses that provide jobs in the community at a competitive disadvantage, it also burdens consumers because the taxes that go uncollected must be made up by higher overall rates on those sales where collection is required.

We believe there are compelling reasons why Congress should act now to level the playing field and allow states that are members of the SST system to require remote sellers to collect the taxes due from customers in their states.

Primary among those reasons is the success of the states in implementing the SST Agreement. The initial goal of the SST Project was to simplify sales taxes as much as possible and make uniform those things that could not be simplified. The SST Agreement has made tremendous strides by providing for uniform definitions, exemption certificate administration, rounding rules, and returns and remittances rules. The current Agreement provides for uniform destination sourcing and requires states to provide a taxability matrix that both sellers and purchasers can rely on to determine whether the items they sell are subject to tax. The SST Governing Board ("SSTGB") has identified Certified Service Providers ("CSPs") who work with businesses to collect and remit taxes, all at the expense of the states.

These changes represent a significant reduction in the burden imposed by the sales tax system in SST states and there are continued efforts for improvement. If the provisions of the SST Agreement are rigorously adhered to, business benefits by lower costs of collection, states benefit by more accurate collection of their revenue and consumers have taxes more accurately collected at a lower cost, which means prices are less likely to rise. Almost half of the states imposing sales taxes have adopted the SST Agreement. We believe significantly more states would do so if there was federal legislation rewarding this effort by granting SST states authority to require collection by all remote sellers.

Retailers of all sizes, formats and channels support H.R. 3396. With this act, Congress would strengthen the SST Agreement by mandating that certain levels of simplification and uniformity be maintained and providing an enforcement mechanism to assure compliance.

A major stumbling block for Congressional action in the past arose from concerns about the burden that even an SST system would place on small business. That burden is illustrated by the results of the JCCS Study. The JCCS Steering Committee was formed to carry out a joint effort of business and government to determine the cost incurred by all sizes of business for collecting and remitting state and local sales and use taxes.

The results of this effort showed that, under the pre-SST system, the weighted average cost of compliance was 3.09% for all retailers. When broken down by retailer size, the JCCS determined the costs are:

- 2.17% for large retailers (those with sales over $10 billion)
- 5.2% for midsize retailers (those with sales between $1 million and $10 billion)
- ***<u>13.47% for small retailers (those with sales less than $1 million)</u>***.

The JCCS Study demonstrates that tax collection places a significant burden on all retailers and a more significant burden on small businesses in relation to their size. While the SST Agreement provides a significant reduction in the burdens and costs of collecting, many of those involved in the SST process have always recognized that there would be residual complexity that could not be removed through simplification and uniformity measures. The significance of the costs generated obviously makes one hesitate to impose the current system's burden on small business. Further, there is a consensus that the collection requirement should not be imposed on small business under any system without some meaningful protection. This opens the question as to what that protection should be.

One answer to this question has been to call for a small business exemption ("SBE"), also included in H.R. 3396. The small business exception alternative has been much debated, and it has resulted in controversy as to what is the appropriate size business to benefit from such an exception. The JCCS Study provides a starting point for measuring pre-SST costs and a method of resolving the SBE controversy. To the extent some believe the data is old or inaccurate, that data can be refreshed, data gathering methods improved and data can be verified. <u>We believe that **compensation** is the best way to help small business deal with this residual complexity</u>.

Compensation as a solution eliminates some of the arbitrariness created by drawing a single line between large and small business. It truly eliminates the burden on interstate commerce, since any burden on commerce would be recompensed in a mandatory system. Because of this, we believe that there should be compensation for all sellers. We believe this is the best way to deal with the residual complexity in the SST system. Compensation serves the two fold purpose of compensating sellers for their tax collection services and rewarding states for simplifying their tax systems. State officials have expressed concerns about the cost of compensation. It is interesting to note that some of them do not seem at all concerned that they are imposing these costs on businesses today!

In a mandatory system, Congress can provide that the SSTGB set a reasonable level of compensation for all sellers based on the results of the most recently conducted JCCS Study. If the SSTGB is unwilling or unable to resolve this issue of compensation, then the solution should be specified in federal legislation like H.R. 3396, establishing compensation as a minimum simplification feature. As stated above, this mechanism would not only deal with small business concerns, but also provide a carrot and stick enforcement mechanism to measure compliance with current simplification and uniformity requirements, and likewise encourage continued efforts to streamline taxes and reduce costs for all concerned.

In conclusion, JCPenney, the National Retail Federation, and most multi-channel retailers of all sizes support the passage of H.R. 3396. Retailers like JCPenney are working diligently to ensure that the SST Agreement is fair for all sellers, and that SSTGB stays focused on uniformity and simplicity. With Congress's help, passage of H.R. 3396 into law would be the appropriate next step to a modern, fair and responsive sales tax system across all participating states and sellers.

Thank you Madam Chair for the opportunity to present the views of retailers, and I welcome your questions.

The National Retail Federation is the world's largest retail trade association, with membership that comprises all retail formats and channels of distribution including department, specialty, discount, catalog, Internet, independent stores, chain restaurants, drug stores and grocery stores as well as the industry's key trading partners of retail goods and services. NRF represents an industry with more than 1.6 million U.S. retail establishments, more than 24 million employees - about one in five American workers - and 2006 sales of $4.7 trillion. As the industry umbrella group, NRF also represents more than 100 state, national and international retail associations. www.nrf.com

Contact Information:

Wayne Zakrzewski
Vice President,
Associate General Counsel-Tax
J.C.Penney Corporation, Inc.
P.O. Box 10001
Dallas, TX 75301-1218
Phone: 972-431-2122
jzakrzew@jcpenney.com

Ms. SÁNCHEZ. Thank you, Mr. Zakrzewski. We appreciate your testimony. You came in right under the 5-minute mark.

We have been summoned across the street for votes, the bells that you have heard. So we are going to take a recess to allow Members to cross the street to vote. And hopefully in that time we will also get a page in here to look at the lighting system. And we will reconvene immediately after the last vote.

[Recess.]

Ms. SÁNCHEZ. I am going to call the Subcommittee back to order. And I want to thank the witnesses for their patience. I believe we are now to Mr. Isaacson.

So, Mr. Isaacson, I would invite you to begin your testimony.

TESTIMONY OF GEORGE ISAACSON, BRANN & ISAACSON, LEWISTON, ME, ON BEHALF OF THE DIRECT MARKETING ASSOCIATION

Mr. ISAACSON. Thank you, Madam Chair and Members of the Committee. On behalf of the Direct Marketing Association and its more than 4,700 member companies, I want to thank you for the opportunity of testifying today and to discuss with you serious concerns that I have, both as an attorney who has practiced in the field of sales and use tax law for more than 20 years and also as a teacher of constitutional law at Bowdoin College.

I have serious concerns that the bill which this Committee is considering would undermine core constitutional principles that have served this Nation well for more than two centuries and would also erect a tax compliance barricade across the electronic highway to the detriment of the very small businesses and medium-sized businesses that have had the opportunity to access the unified national market that the commerce clause has created.

Advocates of the STA have stated that they believe that it is worth abandoning these constitutional principles because of the lost sales tax revenue that they believe that they are suffering. The real problem is that the numbers that are used are totally illusory.

And Mr. Cannon referred to the discrepant numbers that exist between the University of Tennessee study and the recent study that was undertaken by the Direct Marketing Association. And the question then becomes why are these figures so different. And I think that there are three basic reasons.

The first reason is that the growth of electronic commerce just has not been the rocket sled that was predicted in the University of Tennessee study. Growth rates have been much more modest than those predictions anticipated. And that fact has been admitted by the authors of the study.

The second reason and one which is oftentimes missed in this discussion is that 90 percent of electronic commerce, these huge numbers that you hear, are business-to-business sales. And in the business-to-business sales community, there is very little loss of sales tax revenue. And that is because most of those sales are either exempt sales that are made as sales for resales or sales in connection with the manufacturing process or businesses self-report their tax liability to State revenue departments.

A recent study undertaken by the Washington State Revenue Department reported that for Internet sales that are made between businesses, 85 percent of the sales tax is, in fact, collected. So the notion that there is this sieve of lost revenues is not accurate, even when you look at what the overall volume of Internet sales may be.

And perhaps the most significant reason why the University of Tennessee study is inaccurate is because of the fact of multi-channel merchandising, which has really become the predominant clicks and bricks phenomena that, again, Mr. Cannon, described. Most companies that use the Internet to expand their market, develop brand equity, provide customer service find that it is to their advantage to open retail stores or other customer service facilities, create nexus in States, and then commence use tax collection.

In effect, the problem that has been described is largely a self-correcting one. And certainly, much of these figures that we described from Cyber Monday are by companies that are clicks and mortar retailers, are collecting the tax. In that regard, the issue is simply not one that reflects the kinds of numbers that are frequently bandied. And I think we need to be very cautious before surrendering long-established constitutional standards based upon illusory figures.

In my opinion, the streamlined sales tax project has been the wrong approach to this issue. Unlike most uniform laws which are submitted to the Uniform Law Commission that consists of distinguished jurists, law school professors, practicing attorneys, and has produced such works as the uniform commercial code, the Uniform Division of Income for Tax Purposes Act, the famous UDITPA law that State practitioners are very familiar with. That process wasn't followed in this instance.

Instead, this was essentially a government-only exercise. And I think in being a government-only exercise, an agreement negotiated by tax administrators for tax administrators, the project failed to take on some of the key areas of needed tax reform that had been recommended to it by the previously congressionally authorized advisory commission on electronic commerce and by the National Tax Association Project that looked into this same issue.

So, for example, the project early on abandoned the idea of reducing the more than 7,600 different tax jurisdictions in the United States. It failed to address the issue of one rate per State. It failed to address the issue of having a single audit for companies that were registered under the agreement. It failed to come up with even a uniform definition for selling price, which is the core concept that underlies the application of a sales tax rate.

The fact that these issues were simply not addressed because State laws were already too discrepant to reach conformity on those issues shows that there was a low bar that was established at the beginning of the project. Perhaps even more problematically, however, is that the STA has been a moving target.

It has had more than 70 different amendments since it was adopted in 2002. And most of those amendments have been for the purpose of diluting or simply eliminating conformity provisions that were previously in the original agreement that was adopted. That is not the right direction for sales and use tax reform. And there are 20 more amendments that are going to be considered by the governing board at the meeting next week in Dallas.

Ms. SÁNCHEZ. Mr. Isaacson, your time has expired. But hopefully we will be able to follow up with your testimony during the round of questions.

Mr. ISAACSON. Thank you.

[The prepared statement of Mr. Isaacson follows:]

PREPARED STATEMENT OF GEORGE S. ISAACSON

Subcommittee on Commercial and Administrative Law
H.R. 3396 "Sales Tax Fairness and Simplification Act"

December 6, 2007

THE WRONG PATH TO TAX REFORM:
How Parochial State Interests Undermined The Streamlined Sales Tax Project

Testimony of George S. Isaacson
Tax Counsel, Direct Marketing Association

George S. Isaacson
Brann & Isaacson
P.O. Box 3070
Lewiston, Maine 04243-3070
(207) 786-3566
gisaacson@brannlaw.com

Testimony of George S. Isaacson, Esq.
Tax Counsel for the Direct Marketing Association
Before the United States House of Representatives
Judiciary Committee
Subcommittee on Commercial and Administrative Law
December 6, 2007

THE WRONG PATH TO TAX REFORM:
How Parochial State Interests Undermined
The Streamlined Sales Tax Project

Mr. Chairman, Members of the Committee, on behalf of the Direct Marketing Association ("DMA") and its membership, I want to thank you for the opportunity to testify today. The DMA is the largest trade association for businesses interested in direct marketing to consumers and businesses via catalogs and the Internet. Founded in 1917, the DMA today has over 4,700 member companies in the United States and 53 foreign countries.

As both an attorney practicing in the area of sales and use tax law for more than 25 years and an instructor in Constitutional Law at Bowdoin College, I welcome the opportunity to discuss with you the important public policy implications associated with H.R. 3396, the so-called "Sales Tax Fairness and Simplification Act," and the threat it presents to core constitutional principles and America's ability to maintain its preeminent position in the field of electronic commerce.

H.R. 3396 presents a critical policy choice for Congress. Advocates of expanded state tax jurisdiction argue that the need for additional state revenue outweighs the constitutional protections for interstate commerce. Congress should be loathe, however, to set aside these constitutional standards, which have served the nation well for two centuries and created the largest and most vibrant economy in the history of the world. Expanded and overlapping state tax jurisdictions would seriously jeopardize the continued growth of electronic commerce in the United States and it would impede the access of small and medium-sized companies to a nationwide market. Indeed, the Internet has been an incubator for start-up companies and small businesses that have the entrepreneurial ambition and talent to market their goods and services throughout the country. Erecting a tax compliance barricade across the electronic highway is no way to spur economic growth or encourage small and medium-sized companies to expand their markets.

If Enacted, H.R 3396 Would Result In An Unprecedented Expansion Of State Taxing Authority

The Streamlined Sales and Use Tax Agreement (SSUTA) was drafted by state tax administrators for the express purpose of expanding the jurisdictional reach of state tax systems. H.R 3396 now seeks congressional complicity in this effort. The peculiar process by which the SSUTA came into being is a troubling one. Unlike the procedure customarily employed for the development of uniform state laws, which follows the time-tested route of hearings, deliberations, and drafting by the Commissioners on Uniform State Laws in the case of the SSUTA, state tax administrators in this instance chose to bypass altogether the Uniform Law Commission, whose membership consists of distinguished jurists, law school professors, government officials, and lawyers. Instead state tax officials chose to confer almost exclusively among themselves, sometimes even in closed sessions, to produce an agreement that contains scant contribution from the academic community and, most significantly, a rejection of almost all of the suggestions from that portion of the business community that would be most affected by the Agreement, *i.e.*, the direct marketing industry.

The Commissioners on Uniform State Laws have successfully produced over 200 uniform state laws in addition to their landmark work—the Uniform Commercial Code. A number of these uniform state laws deal with multi-state taxes (such as the Uniform Division of Income for Tax Purposes Act UDITPA) and with electronic commerce (such as the Uniform

Electronic Transactions Act). If state tax officials had truly been interested in streamlining, simplifying, and making more uniform the crazy quilt of existing state and local sales and use tax laws, they would have requested that the Uniform Law Commission develop draft legislation for consideration and adoption by state legislatures. The fact that this traditional approach to developing uniform state laws was not employed is revealing of the true motives of state tax administrators. Their goal was neither simplicity nor uniformity, rather their objective was to obtain authority to export their tax systems across state borders and impose tax obligations on businesses that currently are constitutionally protected from over-reaching state tax laws.

The SSUTA is a document drafted by tax administrators for tax administrators, and, as might be expected, it resulted in little in the way of tax simplification. It has not reduced the number of sales/use tax jurisdictions in the United States, which currently number over 7,500. It has not reduced the number of state and local tax rates; indeed, it has authorized an increase in the number of such rates. It has not reduced the number of audits to which an interstate marketer would be subject (each state revenue department would still conduct its own independent audit). It has not produced a one stop/one form tax return and remittance system. It has not halted the explosion of confusing and totally discrepant sales tax holidays, which create mini-tax systems with separate rules of only several days' length. In fact, in certain respects, the SSUTA makes sales/use tax compliance more complex and confusing for both consumers and retailers.

Put simply, Congress should not endorse this misnamed exercise in state tax reform. Instead, this Subcommittee should urge state governors and the direct marketing industry to work together in a genuine and collaborative effort, under the auspices of the Uniform Law Commission, to standardize the administration of state tax laws. The Direct Marketing Association would be a willing and active participant in that process.

State Tax Administrators Have Grossly Over-Estimated Lost Sales/Use Tax Revenues.

The alleged tax revenue benefits of the SSUTA are illusory. SSUTA advocates have grossly exaggerated, by as much as 400 percent, the revenue "losses" states and localities have incurred as a result of the constitutional limitation on their ability to impose tax collection obligations on catalog companies and electronic merchants beyond their borders. The true figure is, in fact, only a fraction of one percent of total state sales and use tax collections. Recent analysis shows that the "lost" revenue for all current SSUTA Full Member States for 2006 totals only $145 million, not the billions of dollars claimed by state tax officials.

The claims of state government officials of enormous revenue "losses" because of uncollected sales and use taxes on electronic commerce are simply not supported by currently available data. Advocates of the SSUTA rely almost exclusively on predictions of lost tax revenue reported by two researchers affiliated with the University of Tennessee ("UT Study"). Their report, first issued in 2000, and then updated in 2001 and reviewed in 2004, is based on non-validated data collected by a private research firm. Actual data from the U.S. Department of Commerce Census Bureau 2007 E-Commerce Report analyzed by DMA Senior Economist Dr. Peter Johnson ("Johnson Study"), however, shows that on-line consumer sales growth has been much more modest than predicted in the UT Study, so that untaxed sales are (and will continue in the foreseeable future to be) much lower than assumed by state tax administrators.

Even more to the point, the UT Study also was founded on a number of faulty assumptions. The Johnson Study is illuminating in this regard (a copy of the study is attached). First, the vast majority of ecommerce – well in excess of 90 percent — is comprised of business–to–business ("B to B") transactions on which transaction taxes are either collected by vendors or remitted by companies that self-report the use tax. Most B-to-B transactions (88%) are conducted via electronic data interchange ("EDI"), for which the sales/use remittance rate is effectively 100 percent. Even for the much smaller portion of B-to-B sales conducted over the Internet, a recent study by the Department of Revenue for Washington State indicates a sales/use tax remittance rate of 85 percent. Thus, the implication that states are "losing" a substantial portion of their sales tax revenues to electronic commerce is simply false, because the vast majority of e-commerce transactions are not consumer sales.

Furthermore, even as to business–to–consumer ("B–to–C") Internet transactions, state estimates of uncollected tax revenues are grossly inflated. Again, the UT Study over-estimated both total e-commerce growth and B-to-C growth, so state projections of gross revenue potentially subject to tax are far off the mark. Moreover, as the authors of the UT Study conceded in 2004, there are many more multi–channel retailers (*i.e.*, retailers with both retail stores, Internet websites, and, in some cases, catalog operations) that have commenced collection of sales/use tax on their Internet and other remote sales than originally estimated by the UT Study. In this regard, the perceived "problem" of catalog and Internet vendors not collecting use tax has proven to be largely self–correcting. As remote sellers grow, most of them embark on a multi–channel sales strategy, which includes opening retail stores and a corresponding decision to begin collecting state sales/use taxes voluntarily on all sales (including Internet sales) to residents in states where their stores are located.

Correcting for these and other flaws in the UT Study and relying on actual data from the U.S. Commerce Department, the Johnson Study shows that the amount of sales/use tax which remote e-commerce retailers could not be compelled to collect for all states is a mere fraction of the amount predicted in the UT Study. In total, combining B-to-C with B-to-B transaction data, "uncollected" sales and use taxes on on-line sales is best estimated to be only **0.2 percent** of all state and local tax revenues for 2006. For the 15 states that are currently Full Members of the SSUTA, this translates into $145 million in total, not the many billions of dollars claimed by SSUTA advocates. (In fact, SSUTA Member States have probably experienced somewhat higher tax collections than indicated above, as a result of voluntary participation in the SSUTA by some retailers that might otherwise not have decided to collect use tax.)

In light of these figures, I would hope that members of this Committee would question whether forsaking long-standing constitutional standards is the proper response to the greatly exaggerated, and largely self-correcting, problem of lost use tax revenue claimed by state tax officials.

Jurisdictional Limitations On State Taxing Authority Are Not A Legal "Loophole" Exploited By Retailers, But Rather Derive From Core Constitutional Principles.

The stated purpose of H.R. 3396 is to authorize Member States of the SSUTA to subject businesses not located within their borders— *i.e.*, companies lacking "nexus"—to tax collection and remittance obligations. This is no trivial matter. Determining the appropriate reach of the sovereign authority of state and local governments is central to the American system of government. Indeed, the Constitutional Convention of 1787 was initially called to address the problem of individual state legislatures imposing taxes and duties on trade with other states, a practice that was pushing the young country into a depression. The solution devised by the Constitution's Framers was a federal system of dual national and state sovereignty, the genius of which is that *each state is sovereign within its own borders* and can adopt those policies that best suit its particular needs and reflect the political preferences of its citizens. Needless to say, this plan has worked remarkably well for more than 200 years.

Of necessity, federalism restricts the ability of a state (or locality) to export its tax system across state borders. Permitting each state to visit its unique tax system on businesses that have no nexus with the taxing state would be chaotic as a matter of both tax administration and compliance (involving fifty state governments, and the more than 7,500 local taxing districts in the United States, imposing their vastly different tax regimes on businesses in each of the forty–nine other states). Moreover, out–of–state companies would have no way to influence the very state tax systems that are newly imposed on them. In the most real sense, allowing the expansion of tax authority beyond state borders is "taxation without representation."

The Constitutional limitations on the territorial scope of state and local taxing jurisdiction also has enormous economic importance. The United States Constitution – and the Commerce Clause in particular – has been the guardian of this nation's open market economy. A central purpose of the Commerce Clause was to prevent states from suppressing the free flow of interstate commerce by imposition of taxes, duties, tariffs, and other levies. Indeed, more than two centuries before the establishment of the European Union, the Framers of the United States Constitution created a common market on this continent through the Commerce Clause, and their foresight powered the greatest economic engine mankind has ever known.

In this era of electronic commerce and increased international competition, it is imperative that Congress not abandon, or undermine, the core Commerce Clause principle of a single, free-flowing national marketplace. In the last two decades, U.S. companies have been dominant in the field of electronic commerce; but abandoning constitutional ideals in favor of short-sighted efforts to increase state tax revenues could undermine the position of American companies in this crucial, but still fledgling, sector of the world's economy. The vitality of e-commerce should not be curbed by federal legislation that saddles American businesses with the burdens of disparate state tax laws whose authority extends far beyond traditional jurisdictional borders.

With record high energy prices threatening the nation's economy, now is certainly not the time for Congress to abandon the original intent of the Commerce Clause. Moreover, debate over the wisdom of a federal law to expand state and federal tax jurisdiction cannot be divorced from consideration of the impact such legislation would have on the competitiveness of American companies. Forcing new tax collection obligations on U.S.-based companies would have the undesirable (and undoubtedly unintended) effect of advantaging their foreign competitors, on whom state and local tax collection obligations could never be effectively imposed.

Congress should be skeptical of arguments that the Commerce Clause is outdated and its restriction on state taxing authority is nothing more than a constitutional loophole exploited by business. As a professor of Constitutional Law, I respectfully disagree. In my view, the Supreme Court's consistent application of long-standing constitutional principles should not be viewed as a "problem" in need of correction. Rather, the inter-related ideals of federalism and unfettered interstate commerce have made America both the greatest experiment in representational democracy and the most successful economy the world has ever known.

H.R. 3396 Would Unfairly Burden Businesses In A Majority Of States To Satisfy The Demands Of A Minority States That Are Members Of The SSUTA.

The proposed legislation being considered by this Subcommittee would be unfair to the great majority of states—including California, Texas, New York, Florida, Illinois, Pennsylvania, and Massachusetts—which have elected not to become members of the SSUTA. The burdens of H. R. 3396 would fall primarily on businesses in those states that will realize no reciprocating benefit. The legislation grants favored treatment to the minority of states that are Full Members of the SSUTA (only 17 states, representing approximately 25 percent of the nation's population). The bill would allow those few states to impose tax collection, reporting and remittance duties on *retailers in every other state in the nation*, regardless of whether a state is a member or not a member of the SSUTA.

Most states that participated in the Streamlined Sales Tax Project have decided not to become members of the Streamlined Sales and Use Tax Agreement for a variety of different reasons. The most common reason is that these states (primarily larger states) do not want to surrender their tax sovereignty to the dictates of the SSUTA Governing Board. Consequently, most states have concluded that membership in the SSUTA would be detrimental to their best interests.

H.R 3396 would, nonetheless, force non-participating states to tolerate the incongruous situation in which companies headquartered in their states are required to collect sales/use taxes for SSUTA member-states, but there would be no similar and reciprocal obligation on the part of retailers located in the SSUTA member-states. To put the issue in more specific terms, under this bill, an Internet retailer based solely in California or Massachusetts (neither of which are SSUTA members) would be subject tax collection, reporting and remittance obligations for its sales to residents of Nebraska, North Carolina, Wyoming, and every other SSUTA state, but neither California nor Massachusetts would receive any additional tax revenue from an Internet retailer with operations solely in any of the SSUTA member states. In this regard, H.R. 3396 is hardly a bill promoting sales tax fairness for retailers, consumers, and states through the country.

Supporters of H.R 3396 argue that the legislation would encourage additional states to bring their sales/use tax laws into compliance with the SSUTA. But this is faulty and selfflattering reasoning. If the SSUTA were attractive on its own merits, more states would have already joined. Instead, the reality is that the legislatures in the vast majority of states, making up more than 70 percent of the United States population and including each of the six largest states in the nation – California, Texas, New York, Florida, Illinois, Pennsylvania – have chosen not to adopt the SSUTA for good reasons. Legislative leaders in those states have concluded that the SSUTA is simply not consistent with their state's tax scheme (*e.g.*, sourcing requirements) or otherwise is not in the state's best interest. Large states are also skeptical of handing over authority to an SSUTA Governing Board dominated by tax administrators from smaller states. Moreover, because the SSUTA has been so frequently amended by the Governing Board despite the short life of the Agreement, these larger states are concerned over what future requirements might be imposed upon them by the Governing Board in the event they were to become Full Members.

In fact, it is this inherent tension between the insistence of states on maintaining sovereignty, pitted against the desire to expand their taxing jurisdiction, that has made the SSUTA fatally flawed and doomed to fail in achieving real simplification and uniformity in state and local sales and use tax systems.

The SSUTA Adopted "Low Bar" Reform From The Outset And Has Proven To Be A Moving Target Of Increasing Complexity And Decreasing Uniformity.

Although nominally a bold reform initiative to simplify, harmonize and modernize state and local sales and use tax laws, the Streamlined Sales Tax Project has never promoted true simplification or uniformity. Instead, state tax administrators, from the outset of the Project, and at every turn since, have sacrificed real reform to accommodate the peculiarities of individual states tax systems. The goal of the Project's organizers was not to maximize uniformity among state laws, but rather to maximize the number of states willing to sign-on to SSUTA full membership .

The inevitable result of this recruitment-at-all-costs strategy has been the progressive dilution of the Project's stated uniformity objectives. Successive compromises of the SSUTA's stated principles have produced a lowest-common-denominator standard for sales/use tax reform. Moreover, these on-going revisions have made the SSUTA a moving target for affected businesses, as they confront frequent amendments, illogical interpretive rulings and a burgeoning number of complex rules. Having closely followed and contributed to the SSTP process over the past 7 years, I find the contrast between the SSUTA process and the more conventional drafting process for uniform state legislation developed by the Commission on Uniform States Laws (such as UDITPA) a most striking one.

The SSUTA Failed To Adopt Fundamental Requirements Of Simplicity And Uniformity.

To understand the dissolution of the SSUTA process, it is instructive to consider its history. The Streamlined Sales Tax Project was launched in 2000 on the heels of two earlier joint government/industry initiatives (the National Tax Association (NTA) Communications and Electronic Commerce Tax Project, and the congressionally–established Advisory Commission on Electronic Commerce), both of which had concluded that the existing state sales and use tax system was one of daunting complexity, and that true simplification would require sweeping reforms. To this end, in August 2000, the Direct Marketing Association set forth in a letter to Steamlined Sales Tax Project leaders a comprehensive list of reform proposals, a copy of which is attached to my written testimony. The fate of DMA's proposals is telling: of more than 30 specific reform recommendations offered by the DMA, the SSUTA fully adopts only two, centralized registration and uniform bad debt provisions, and the latter provision has not been honored by most of the member states.

Perhaps most emblematic of the SSUTA's failure to achieve genuine sales/use tax reform was the early demise of the single most important step toward simplification: the adoption of a single sales and use tax rate per state for all commerce ("one rate per state"), which would have eliminated the problem of merchant compliance with thousands of local tax jurisdictions with different tax rates. The United States is the only economically developed country in the world with a system of sub-state transaction taxes not only for municipalities and counties, but also for school districts, transportation districts, sanitation districts, sports arena districts, and other local tax jurisdictions. In light of this wildly complex system, the adoption of a "one rate per state" standard was the unanimous recommendation of the NTA's E-Commerce Project (which included delegates from the National Conference of State Legislatures, National Governors Association, and the U.S Conference of Mayors) and was also the majority report recommendation of the Congressional Advisory Commission.

Despite this background, the SSTP abandoned the "one rate per state" standard early in its deliberations, and instead decided to permit (a) two state-level rates (one of which only applies to food, food ingredients, and drugs) and (b) additional separate rates as chosen by each local taxing jurisdiction in the state. The effect of this decision was to allow an increase, rather than require a decrease, in the number of sales/use tax rates to which an interstate merchant might be subject in collecting and remitting taxes.

How could such a fundamental goal of sales/use tax reform be forsaken so early in the SSTP process? State tax administrators associated with the SSUTA now freely admit that the "one rate per state" proposal was dead on arrival, because they quickly were informed that it was unacceptable to most states and localities who clearly prized their unique taxing prerogatives over the uniformity and simplification recommendations of the prior commissions.

I have had the opportunity, in testimony before this Subcommittee (in October 2003) and last year (July 2006) before the Senate Finance Committee, to explain in detail numerous other ways that the SSUTA disregarded broadly recognized principles of sales/use tax simplification and standardization, and I would be happy to provide copies of such testimony to the Subcommittee members. In brief, a few of these glaring shortcomings include:

- **The failure to establish uniformity in the tax base:** The SSUTA rejected from the outset adopting a uniform tax base, instead insisting that uniform definitions among states for taxable and exempt products would be adequate simplification for retailers. But the number of product definitions in the SSUTA to which member states must adhere is very limited, and states can choose to exempt or tax any product or service not specifically defined. The Agreement has no definitions that would cover many every day consumer items, from cookware to holiday decorations to home and garden items.

- **There is no uniformity in the measure of tax for like transactions**: The SSUTA also does not simplify the way retailers must measure the dollar amount (transaction value) subject to tax. Instead, the SSUTA's definition of "sales price" allows states to include, or exclude, multiple components, resulting in a dizzying array of state-specific alternatives, with no uniform measure of tax among states for identical transactions. In fact, as explained later, the SSUTA has recently made the determination of "sales price" even more complex.

- **There is no meaningful reduction in the burdens of tax collection, reporting, remittance and audits for interstate marketers**: State tax administrators refused to adopt a proposal for joint audits (i.e., one audit for all member states). As a result, the number of tax audits to which an interstate marketer would be subject under H.R. 3396 would substantially increase over current practice, since non-nexus companies would become subject to audit not only by the state revenue department in their home state, but by tax auditors from each of the member states, at considerable additional administrative burden and expense to America's retailers.

- **The SSUTA failed to seek independent testing of tax compliance software tax compliance software**: While SSUTA officials rely heavily on computer technology as the "silver bullet" to address the increased tax compliance burdens that would result from passage of H.R. 3396, the Project never sought independent testing of the software systems put forward by service providers (none of which were originally developed for the purpose of SSUTA compliance), and instead conducted the certification process internally. To date, the SSUTA has certified 3 private companies, but many retailers, after investigating the available providers, have concluded that using their software would be prohibitively expensive without any real guarantee of accuracy. Moreover, despite the fact that private service providers will have access to highly confidential personal consumer information, the SSUTA has no articulated standards for assuring the security and privacy of such information.

- **The failure to guarantee fundamental fairness with respect to vendor compensation for tax collection**: On its face, the SSUTA, since its adoption in 2002, has required states to compensate both third party service providers and self-reporting vendors for the considerable costs of serving as the states' collection agents, but five years later the Governing Board has only approved compensation for the certified providers (who would not, of course, have sought certification otherwise), and has reneged on its promise of compensation to retailers.

The SSUTA Has Been Steadily Weakened Since Its Adoption Through A Myriad of Amendments And Interpretive Rulings That Lessen Its Uniformity Requirements And Increase Its Complexity.

Regrettably, the SSUTA has suffered a further "lowering of the bar" since its initial adoption. Again, in stark contrast to a truly Uniform Act, such as the Uniform Division of Income for Tax Purposes Act, which was promulgated 50 years ago and has remained remarkably stable over time, the SSUTA has already been subject to more than 70 amendments during its short life span. Not surprisingly, there are nearly 20 additional proposed amendments on the agenda for the Governing Board's meeting next week. Dozens of the Agreement's provisions have been materially modified; whole sections have been repealed or replaced; and new sections have been added. At the same time, the Governing Board has issued numerous interpretive rulings which, rather than requiring member states to conform strictly to the Agreement's provisions, have instead tolerated widely disparate practices by member state revenue departments. The result has been to increase, rather than reduce, variations in the administration of state tax laws. In a very real sense, the SSUTA is a moving target, adding new uncertainties for businesses and increasing both their compliance costs and their exposure to unanticipated tax assessments.

The SSUTA Has Openly Authorized States To Adopt Replacement Taxes.

Many of the recent amendments to the SSUTA, as well as those currently under consideration by the Governing Board, represent a further degradation of even the modest uniformity provisions contained in the Agreement when it was first adopted. The enactment by member states of "replacement taxes," and the now infamous example of the "fur clothing tax," has become emblematic of the Governing Board's refusal to stand firm and of member states' refusal to abide by the Agreement's requirements. Instead, the Governing Board has tolerated, at times even encouraged, blatant departures from the substance and spirit of the SSUTA on the part of state governments in order to avoid member states from withdrawing, or being disqualified, from membership in the SSUTA.

The replacement tax issue came to the fore in the following way. SSUTA advocates proudly point to the list of product definitions as the Project's central accomplishment in achieving greater uniformity. Member states are required to adopt the definitions, and must then either tax, or exempt, all items that fall within each product definition. Among the defined products is "clothing," defined as "all human wearing apparel suitable for general use," with a lengthy, non-exclusive list of examples within the definition that includes furs. Observers, I among them, noted that the Full Member state of Minnesota exempted "clothing" from sales and use tax, but separately imposed an excise tax on fur clothing, in apparent violation of the Agreement.

In 2006, I submitted a request to the SSUTA Governing Board for a determination whether the fur clothing tax imposed by Minnesota violated the Agreement. In response, the SSUTA's Compliance and Review Committee determined, and the Governing Board agreed, that because the fur clothing tax was denominated in Minnesota's statute as a gross revenues excise tax separate from its general sales and use tax, it was not subject to the Agreement's requirements. In other words, simply re-naming a sales tax as an excise tax frees a state from the requirements of the SSUTA. The ruling clearly signaled to all states (current SSUTA members and those states that had reservations about surrendering tax sovereignty to the SSUTA) that they were free to game-the-system simply by re-naming transaction taxes to take them outside the scope of the Agreement.

This message was readily received by other states. For example, the legislature in New Jersey, another "Full" SSUTA Member, soon followed suit, enacting in its 2006 legislative session its own version of the fur tax. The New Jersey law creates a new gross receipts tax on fur clothing, despite the fact that New Jersey otherwise exempts "clothing" (as defined in the SSUTA) from its sales tax. Moreover, the New Jersey fur tax applies at a rate of 6 percent, despite the fact that New Jersey in 2006 raised its general sales and use tax rate to 7 percent. As a result, the New Jersey fur tax flaunts not only the definitional requirements of the SSUTA, but also the requirements that members have only one state–level sales tax rate (other than for food and drugs).

Following the enactment of the New Jersey tax, there was an outcry among observers, and even some supporters, of the SSUTA. Such "replacement taxes," *i.e.*, sales and use taxes re-named to avoid the Agreement, undermined the integrity of the entire SSUTA process. The SSUTA's Business Advisory Committee, comprised of industry supporters of the Agreement, was highly critical of the enactment of replacement taxes. Proposals were presented to the Governing Board to prohibit the practice. To date, however, these proposals have not been acted upon, and the SSUTA Governing Board has failed to pass an amendment, or even a resolution, that would prohibit state legislatures from making an end-run around the SSUTA by adopting replacement taxes.

Rather than punish states that have enacted replacement taxes, the Governing Board has instead chosen the path of least resistance. Its approach has been: "If a state violates the Agreement, we will simply change the Agreement." With the fur clothing tax, rather than disciplining New Jersey, the SSUTA in December 2006 amended the Agreement to remove fur from the general "clothing" definition and approved a new, separate definition of "fur clothing," thus allowing separate tax treatment for fur clothing and glossing over the non-conformity of both New Jersey and Minnesota.

The SSUTA Has Eliminated Uniformity In The Treatment of Delivery Charges.

The SSUTA Governing Board's willingness to bend and amend the Agreement to accommodate state-specific tax practices has taken a decidedly disturbing turn in connection with the treatment of delivery charges. Consumers need to know whether sales tax will be computed before or after inclusion of "shipping and handling charges." Early in the streamlining project, the Direct Marketing Association urged uniformity on this subject for the benefit of consumers and retailers alike. Not only did the SSUTA not incorporate DMA's original proposal, but recently it has taken a giant step backward from the position taken at the time of the Agreement's original adoption.

A little background on this subject may be useful in understanding direct marketers' concerns. The tax treatment of charges to consumers for delivery of products has long been an area of considerable complexity. Some states impose tax on all delivery charges; others exempt all delivery charges so long as they are separately stated on the invoice; some states tax handling charges, but not common carrier freight charges; most, but not all, states exempt postage charges for direct mail paid to the USPS, even if the state taxes freight charges by a private carrier; some exempt "shipping" charges only if they represent the actual cost of shipping a particular product, but not if the charge is based on average shipping costs; and the list goes on.

Initially, the SSUTA sought to simplify the definition of "delivery charges" to include all charges related to delivery of product to a purchaser, which meant not only shipping costs, but also handling and other charges (including postage, a decision which allowed some member states to impose new taxes on postage they had not previously levied). At the same time, however, the SSUTA protected state tax prerogatives (at the expense of uniformity) by listing delivery charges among those items that a state could elect to include, or exclude, from the taxable "sales price" of the product.

Under political pressure from a number of quarters, including states that previously separated the tax treatment of shipping from other charges, the Governing Board in September 2007 approved an amendment that modifies the definition of "delivery charges" under the Agreement to allow member states to treat "shipping" separately from "handling," undoing any simplification that had previously been achieved. Beginning in 2008, SSUTA member states may elect to tax both shipping and handling, may tax neither, may tax only shipping and not handling, or vice-versa. As a result, the number of possible permutations of the taxable "sales price" that consumers and retailers may encounter has greatly increased.

The SSUTA Has Interpreted Some Definitions, In Particular "Direct Mail," To Apply Only For Administrative Purposes, Leaving States Free To Tax or Exempt Multiple Additional Products.

In addition to amendments to the Agreement, the official Interpretations issued by the SSUTA Governing Board and its committees have further degraded any claim to uniformity. For example, the SSUTA contains a definition for "direct mail," *i.e.*, printed material delivered at no charge via U.S. Mail or by another delivery service to a mass audience or persons identified on a mailing list. This is an area of great importance to the direct marketing industry. In October 2006, the SSUTA received a seemingly innocuous request "[w]hether billing invoices, return envelopes and any additional marketing materials are included in the definition" of direct mail. Although on its face this was a question about the definition, the answer had additional significance because Member States are authorized to allow a different tax treatment for "delivery charges" on direct mail transactions, *i.e.*, to include or exclude such charges on direct mail in a manner different from the state's treatment of delivery charges for most products.

The SSUTA's Interpretations Committee found that the invoices, envelopes and other items met the SSUTA's definition of direct mail, but then went on to state that the definition of "direct mail" in the Agreement applies only for the purpose of determining proper "sourcing" of sales transactions, and *not* for determining whether "delivery charges" are included in the taxable price! The Governing Board subsequently approved the ruling in December 2006.

The direct marketing industry was left totally confused. As a strained rationale, the SSUTA stated that the "direct mail" definition appears in the Agreement's "Administrative Definitions" and not its "Product Definitions," so that the Agreement does not purport to define, at all, what categories of printed material are subject to tax in a Member State, and what categories are not subject to tax. In other words, states could have conflicting definitions and categorization of direct mail for different tax purposes. Indeed, several SSUTA Member States have chosen to tax and exempt different categories of printed materials, all of which appear to meet the uniform definition of "direct mail" under the Agreement. The result is that even though the SSUTA purports to define "direct mail," sellers and buyers cannot look to the Agreement to determine whether their products and services are subject to tax or not, or what taxable measure applies to the transaction.

The Interpretive Ruling that the SSUTA's "Administrative Definitions" cannot be relied upon to determine which types of "direct mail" are taxable and which are not, is disturbing, yet there are now proposed amendments pending before the Governing Board that would formalize and extend that understanding to all Administrative Definitions in the Agreement. Currently, the "Administrative Definitions" include such terms as "bundled transaction," "delivery charges," "telecommunications non-recurring charges," none of which apparently can be relied upon anymore by retailers for guidance except in regard to the "administration" of taxes under the Agreement. Perhaps most incredibly, the Administrative Definitions include the SSUTA's definition of "tangible personal property," the bedrock definition of every sales and use tax system. On even this point, the SSUTA has implicitly disavowed uniformity among the Member States.

Sales Tax Holidays Defeat Uniformity, And The SSUTA Fails To Resolve This Problem.

One of the myriad ways the SSUTA has bowed to parochial state concerns is through its preservation of sales tax "holidays," the temporary suspension of sales and use taxes on particular products or classes of products, such as clothing, computers or school supplies. Sales tax holidays are increasingly attractive to state legislatures as (a) a form of consumer tax relief, (b) a way to encourage purchases that will promote certain state government policy objectives, and (c) a means of stimulating the economy around specific seasonal events, such as the start of the school year. Although this form of short-term tax incentive is very popular with the public, and always focused around local events, sales tax holidays present enormous complexity to interstate retailers, who need to publish tax instructions on their websites and in their catalogs.

The SSUTA currently permits members to implement such tax holidays only with respect to product categories specifically delineated in the Agreement (such as clothing or school supplies). The Agreement, however, imposes no limit on the duration of such holidays, and allows states to impose eligibility thresholds, so that the temporary exemption applies to purchases only above a minimum dollar amount, increasing the complexity for retailers to administer tax holidays.

The popularity of sales tax holidays among state legislatures means that new proposals for such holidays are frequent. Now before the Governing Board is an amendment proposed by North Carolina, a Full Member state, to allow a sales tax holiday for all products that qualify for "Energy Star" designation under guidelines set by the U.S. Department of Environmental Protection. According to the EPA, products in *more than 50 categories* qualify for the Energy Star label. Authorizing a sales tax holiday based on such a designation would have the effect of creating a new mini-tax system of limited duration. Moreover, every SSUTA Member State would be free to choose whether, when and for how long to implement such a holiday, imposing enormous burdens on retailers. It is precisely the pursuit of such state-specific tax policy objectives that generate the overwhelming complexity in sales and use tax systems.

Even more complex proposals for sales tax holidays are being considered by state legislatures. This year, the State of Florida (not currently a Member of the SSUTA) adopted a "Hurricane Preparedness Sales Tax Holiday" running for 10 days in late May, 2007 designed to encourage residents to prepare for the hurricane season. The holiday applied to dozens of types of products in multiple categories, such as candles and flashlights, coolers and ice chests, cell phone batteries, radios, tarpaulins, and window shutter materials. Moreover, the exemptions for different types of products applied only *below* a specified dollar cap, such as $20 for gas-powered lanterns, $50 for bungee cords, and $75 for carbon monoxide detectors. This may be laudable tax policy, but allowing such a system to be exported across state lines would require retailers across the country to comply with the unique policy prerogatives of distant states. Such a system would place crushing burdens on interstate commerce.

The SSUTA Is Poised To Compromise Its Adoption Of Uniform, Destination-Based Sourcing.

The one rate per state proposal has recently re-surfaced in the debate among SSUTA members concerning the "sourcing" of transactions for sales and use tax purposes. "Sourcing" is the term used by tax analysts to describe the mechanism for determining which jurisdiction will have the opportunity to tax a particular transaction. The issue of sourcing would be far less controversial under a "one rate per state" rule, because the absence in variation among tax rates within a state would make sales tax compliance straightforward. However, when local rates differ widely, the issue of which jurisdiction gets to tax the transaction becomes very confusing. Does a merchant who delivers product from one jurisdiction to another charge sales tax at the merchant's home district rate ("origin sourcing") or must the retailer "source" the sale to the location where the product is received and collect tax based on the recipient's jurisdiction ("destination sourcing")?

The SSUTA originally committed itself, for reasons of simplicity and uniformity, to destination sourcing for all transactions. This meant that a retailer would collect tax for the state and local jurisdiction where the consumer – not the retailer – is located. This effort at uniformity has not gone down well, however, with a number of states and localities that permit or require origin sourcing for in-state vendors. Consequently, the SSUTA Governing Board has been asked to abandon its commitment to destination sourcing and accommodate states that want to have destination sourcing at the state level but origin sourcing at the local level. Such a change in the

SSUTA would hardly serve the interests of consistency, simplicity, and uniformity. But those concerns have not deterred the Governing Board from amending the Agreement in the past.

If a state allows origin sourcing for in-state businesses, while demanding destination sourcing for out-of-state businesses (as some of the proposed amendments would permit), there is an obvious issue of fairness. Moreover, if the combined state and local tax rate applicable to an in-state seller is lower than the combined rate applicable to an out-of-state seller for a comparable transaction, the Supreme Court has ruled that such a tax scheme violates the Commerce Clause and is unconstitutional. *Associated Industries of Missouri, Inc. v. Lohman,* 511 U.S. 641 (1993).

An obvious question is: "Why would the Governing Board consider abandoning its straightforward commitment to destination sourcing for all transactions and, instead, create a complex set of rules that would differentiate between state and local taxes on the one hand, and in-state and out-of-state sellers on the other hand?" The answer is that the Governing Board is willing to abandon principle to attract new Member States.

Instead of insisting on state conformity with the original requirements of the SSUTA as a condition of Full Membership, the Governing Board is trying to broker a "compromise" that would permit states to retain their origin sourcing rules. Interestingly, Indiana, one of the states represented on the Governing Board, has proposed an amendment that would, in effect, allow a member state to adopt a separate single rate for delivery sales (in contrast to over-the-counter sales). This would have the effect of keeping compliance burdens on in-state sellers light, but it would also eliminate much of the unfairness of disparate sourcing rules for out-of-state sellers. Thus, under the Indiana proposal, states with origin sourcing could join the SSUTA without adopting destination sourcing, if they would adopt one rate per state. Although the Indiana proposal is on the agenda for the meeting of the SSUTA Governing Board next week, and has considerable support among the business community, Governing Board officials have indicated in public meetings that they feel the proposal does not even merit discussion, because states with origin sourcing will never accept the "one rate per state" alternative, showing again that real reform under the auspices of the SSUTA is impossible.

The DMA has expressed its concerns regarding multiple sourcing provisions for a single state in a letter to the Governing Board. I attach a copy of my letter dated September 12, 2007.

The SSUTA Has Repeatedly Compromised Conformity Standards In Order To Increase Or Maintain Membership.

The SSUTA has repeatedly demonstrated a willingness to descend to the lowest-common-denominator of uniformity in order to accommodate members and potential members, and it has likewise repeatedly bent and even changed its rules regarding compliance requirements. The purpose behind this progressive lowering of the bar has been to enlist and retain member states that are unable or unwilling to bring their laws in line with the Agreement's requirements.

A Weak Compliance Standard. To become and remain a member of the SSUTA, a state must only certify to the Governing Board that the "effect" of its laws, rules, regulations and policies is "substantially compliant" with each of the requirements of the Agreement. This weak standard of compliance means that there is no guarantee that any Member State's laws are fully compliant with the terms of the Agreement to begin with. This is only one way that the SSUTA has enabled states to circumvent its compliance requirements.

The SSUTA Began By Creating a Class of Not Fully Compliant "Associate Members." Initially, the Agreement, by its terms, was only to take effect when at least ten states comprising at least twenty percent of the total population of all states imposing a state sales tax were determined to be in conformity. The participating states set a deadline for themselves of October 1, 2005 to achieve this level of conformity.

The SSUTA Governing Board was so concerned, however, in April 2005 that it would not secure the membership of enough states to meet their self-imposed threshold, that it quickly adopted a new provision allowing for so–called "Associate" Members, which were states that the Project participants acknowledged had not yet conformed their laws to the Agreement, but which states would, nonetheless, be counted toward the critical mass necessary for the SSUTA to become effective. State representatives to the SSUTA have publicly acknowledged that the provisions regarding Associate Members were adopted in haste in 2005, without careful consideration of all of the ramifications of creating this second class of members on other parts of the Agreement, in order to "meet the quota" necessary for the SSUTA to take effect.

When this new category of membership was created in April 2005, Associate Members were given more than three-and-a-half years, until December 31, 2007, to bring their laws into full conformity with the Agreement, or they would forfeit their Associate Membership status. At the time the participating states declared success in meeting the membership threshold on October 1, 2005, there were six states granted Associate Membership status: Arkansas, Nevada, Ohio, Tennessee, Utah, and Wyoming. Together with the thirteen states granted Full Membership, the SSUTA claimed to have enlisted states comprising a little more than 29 percent of the population as of October 1, 2005.

The SSUTA Next Refused to Expel Utah After Its Legislature Repealed Conformity Legislation. After creating the Associate Member category, SSUTA officials have shown themselves ready to take any measures necessary to prolong the membership of Associate Members. The first such compromise came in 2006, when the legislature in Utah, one of the

Associate Member states, repealed a large number of laws that had originally been enacted to bring the state into SSUTA conformity. There was no question that Utah's tax code was no longer in compliance with multiple SSUTA requirements and that the state did not, after the repeal legislation, meet the standard for Associate Membership.

Rather than take steps to terminate Utah's SSUTA membership, the Governing Board determined that it was not required to expel Utah on the theory that, under the Agreement, the status of Associate Members did not need to be reviewed until the December 31, 2007 deadline for full conformity. The Governing Board simply declined to take up the matter of Utah's non-compliance and, as of this date, Utah remains an Associate Member, accepting SSUTA vendor registrations, participating on SSUTA committees, and voting on matters with other Associate Member states.

The SSUTA Created A New Category of Associate Member to Accommodate Tennessee. While some states originally granted Associate Member status have subsequently petitioned for and been granted Full Membership, the two largest of the states initially granted Associate member status in 2005, Ohio and Tennessee, have remained Associate Members. In Tennessee, a number of the changes in its laws that have proven most controversial within the state were adopted with effective dates pushed off well into the future for political reasons. The proposed effective date for many such laws had been July 1, 2007, in time for the December 31, 2007 deadline for Associate Member States to come into full compliance. But in the 2007 legislative session, the Tennessee legislature pushed back the effective date on many provisions until July 1, 2009, delaying the date for the state's possible conformity until after the SSUTA's previously set deadline.

Rather than Tennessee losing its membership status, the SSUTA in June 2007 promptly enacted an amendment to the Agreement which created a new category of Associate Members, described as states petitioning for membership after January 1, 2007. Such states are qualified for Associate Membership status if they are found to be in compliance with the Agreement's requirements except that the effective date of their conformity is delayed for not more than twelve months, or with Governing Board approval, eighteen months, beyond their proposed entry date into the Agreement.

Although Tennessee was already an Associate Member prior to January 1, 2007, it was nevertheless permitted to petition for Associate Member status under the new provision for Associate Members petitioning after January 1, 2007. The Governing Board promptly approved Tennessee's Associate Member status under the new provision, based on its proposed new conformity date of July 1, 2009. These machinations are little more than smoke and mirrors.

The SSUTA is Poised to Make Concessions on Origin Sourcing to Extend The Deadline For Ohio. Of considerable concern now to SSUTA officials is the impending failure of Ohio, the largest state with membership status in the SSUTA, to gain full membership status by December 31. For Ohio, the central issue of non-conformity is its system of in-state origin sourcing. With Ohio's deadline to conform to the SSUTA approaching, the Ohio legislature in the 2007 legislative session not only declined to adopt destination sourcing, but affirmed its system of origin sourcing. As a result, Ohio will not meet the December 31, 2007 deadline for conformity, and will be required under the current language of the Agreement to forfeit its membership.

SSUTA officials desperately want Ohio to retain its membership and, indeed, to attain Full Member status. Indeed, the possibility of Ohio falling out of the SSUTA, together with the desire to attract other states that have origin-based sourcing, is driving the Governing Board's push to amend the agreement and depart altogether from a uniform destination-based sourcing standard.

At the same time, separate amendments have been proposed regarding Associate Member status that would prolong Ohio's membership. One such measure would simply extend the current conformity deadline by an additional six months, to July 1, 2008. Another would allow the Governing Board to approve Associate Membership for a state whose only area of non-conformity is with SSUTA sourcing rules. The proposed amendments will be voted upon at next week's Governing Board meeting. Given the SSUTA's track record to date, it will come as no surprise if Ohio is granted some form of reprieve and remains an Associate Member for some additional period of time. When it comes to membership status, SSUTA rules are meant to be waived not enforced.

The Governing Board Amended the Agreement to Approve New Jersey's Non-Conforming Fur Tax. The SSUTA's weak stance on conformity has also benefited at least one Full Member State. As I explained earlier, the New Jersey legislature in 2006 enacted a replacement "fur tax" which most observers believed was not in conformity with the Agreement's requirement that a state tax or exempt all products for which the Agreement has a formal definition. After New Jersey enacted the fur tax, the SSUTA, rather than disciplining or even expelling the state in its annual re-certification process, simply amended the Agreement to adopt a definition for fur clothing, thus bringing New Jersey's fur tax into *post-hoc* conformity.

Despite Repeatedly Diluting Its Standards, The SSUTA Has Not Attracted Many New Members, And Now Faces Declining Membership

The contortions the Governing Board has gone through to retain members is probably best explained by its inability to attract additional participation by states. The SSUTA has proven unattractive to most states, and the largest states have been most averse to membership. A number of state legislatures, including Florida and Virginia, have outright rejected conformity legislation. Upon the Agreement's effective date in October 2005, the SSUTA had 13 Full Member states; on January 1, 2008, it will have 17. The only states to join as Full Members in the past three years have been Arkansas, Rhode Island, Vermont and Wyoming. The SUSTA is clearly a minority system.

In fact, the SSUTA is losing membership. With Ohio and Utah due to fall out of the SSUTA, the percentage of population will likely fall below the 29 percent level claimed by the SSUTA in October 2005. In fact, if the SSUTA were vigilant regarding compliance and excluded both Tennessee and New Jersey, the percentage of the population represented by Full and Associate Member States participation would fall dangerously close to the 20 percent threshold necessary for the Agreement to remain in effect under its own terms.

It is now time for the Streamlined Sales Tax Project to confront the painful reality that the terms of the SSUTA and its governance procedures are fundamentally flawed, that it has not achieved meaningful sales and use reform, and that is not attractive to the great majority of states. It is time, instead, to re-assess the process that brought the SSUTA to this point and initiate a new process, perhaps through the Commissioners on Uniform State Laws, to craft a truly uniform act whose hallmark is real simplification of state sales and use tax regimes. On behalf of the DMA, I want to thank you again for the opportunity to offer my comments on this important issue.

SETTING THE RECORD STRAIGHT:

THE MODEST EFFECT OF ECOMMERCE ON STATE AND LOCAL SALES TAX COLLECTIONS

Peter A. Johnson, Ph.D.

Vice President Research Strategy and Platforms
Senior Economist
The Direct Marketing Association
Research Strategy and Platforms

1120 Avenue of the Americas
New York, NY 10036
pjohnson@the-dma.org

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Summary

A frequently cited academic study underestimates the amount of state and local tax currently collected on ecommerce sales by as much as a factor of ten. Published in 2000 and revised in 2001 by University of Tennessee researchers, both versions of the study are based on stale data and, at least in hindsight, flawed assumptions. Yet both versions still are referenced in news articles and elsewhere.

Among other shortcomings, the Tennessee study (1) overestimates total ecommerce sales; (2) underestimates B2B tax compliance; and (3) inadequately accounts for sales by multi-channel B2C sellers. The present paper corrects these errors and provides a far more realistic, updated assessment of tax collections on ecommerce sales. For example, in 2006, the total uncollected tax on ecommerce was only $4.2B nationwide or about 0.2% of estimated total state and local tax revenue of $2.12 trillion for 2006.[1] This is less than a tenth of what Tennessee estimated in 2000 and less than a quarter of their 2001 revised estimate.

Beyond these errors, the Tennessee study ignores the effects of three additional factors that could dramatically reduce the sales tax revenues available to state and local governments. The first factor is whether Congress or the Supreme Court ever would allow states participating in the Streamlined Sales Tax Project ("SSTP") to require tax collection by businesses in states not participating. Because, at present, states with over four fifths of the US GDP are *not* fully participating, only about $145MM, or a tiny fraction of total state and local tax revenue would become available in a mandatory collection regime among participating states.

The two other factors ignored in the Tennessee study involve policy proposals to exempt some vendors from collection requirements and to provide collection compensation to other vendors. Because the SSTP has failed to quantify the potentially large effects of these proposals, no attempt is made to quantify them here. But if any seller exception or vendor compensation is provided, there *must* be a reduction of revenue available to the states and localities; the only question is by how much the Tennessee study errs by not considering these factors.

In sum, when properly measured with updated data, the effect of uncollected sales taxes is far more modest than the gaping losses forecast by Tennessee early this decade, and any hopes that increased ecommerce tax collections will significantly fortify state and local government treasuries are illusory, at best.

I. TOTAL ECOMMERCE SALES

Contrary to predictions made in the Tennessee study and elsewhere earlier this decade, ecommerce sales remain a small part of the US economy. As shown in Table 1, in

[1] Projection for 2006 based on actual $2.02 trillion for 2005 as reported by U.S. Census Bureau, Annual Survey of State and Local Government Finances (01-Jun-07).

2005 total ecommerce (excluding services) represented less than 10% of total US commerce. The low portion of US economic activity attributable to ecommerce in the middle of the decade is reflected in a compound annual growth rate ("CAGR") for all ecommerce (B2B and B2C) much lower than that envisioned by Forrester Research and others for this period; it actually was only 17.2% for 2002-05, while the CAGR for B2C alone over the same period was 27.4%.

Table 1: Actual and Projected E-commerce Growth, 2005 – 08 ($billions)

	Actual	Projected		
	2005	2006	2007	2008
Total US Commerce	**$ 19,589.0**	**$21,061.0**	**$22,531.5**	**$ 24,002.0**
All Ecommerce (Net of Services)	**$ 1,834.0**	**$ 2,149.5**	**$ 2,518.7**	**$ 2,952.7**
Ecommerce as % of total:	**9.4%**	**10.2%**	**11.2%**	**12.3%**
Of Which:				
B2B Ecommerce	**$ 1,741.0**	**$ 2,035.5**	**$ 2,381.8**	**$ 2,789.1**
B2C Ecommerce	**$ 93.0**	**$ 114.0**	**$ 136.9**	**$ 163.6**

Source: US Dept of Commerce Census Bureau E-Commerce Report 2007; authors' projections based on historical data Bruce, Donald and William F. Fox (2001): "State and Local Sales Tax Revenue Losses from E-Commerce: Updated Estimates." Center for Business and Economic Research, University of Tennessee.

The Tennessee study, however, accepted Forrester's far higher growth rates (42.1% and 38.1% for total and solely B2C ecommerce, respectively, for 2002 -2005) and has not corrected them fully since that time. Thus it significantly overestimated sales and predicted much higher than actual available tax revenues. Moreover, the growth rate of ecommerce continues to slow faster than the Tennessee study forecast.

Table 2: Comparison of Projected Ecommerce Growth Rates

2002 - 05 CAGR	U of T	Actual
All Ecommerce	42.1%	17.8%
B2B Ecommerce	42.4%	16.7%
B2C Ecommerce	38.1%	27.4%

Source: Bruce and Fox, 2001; US Dept of Commerce Census Bureau E-Commerce Report 2007; authors' projections based on historical data

II. B2B TAX EXEMPTION AND COMPLIANCE

The Tennessee study significantly underestimated both the B2B share of total ecommerce and the tax compliance rate for B2B sales in total ecommerce and, as a result, systematically underestimated the amount of sales/use taxes already collected.

There are two basic types of B2B ecommerce. One type is that conducted via closed Electronic Data Interchange (EDI) networks of mainframe computers. EDI accounts for a whopping 88% of all ecommerce transactions. These closed networks are used for transactions in the manufacturing process. The majority of goods involved are not subject to sales or use tax; for those that are, the proprietary nature of these systems means remote sellers who participate automatically incur nexus, making the tax compliance rate on EDI sales effectively 100%.

The other type of B2B ecommerce is that conducted via the Internet. The US Government's 2000 GAO report on ecommerce surveyed the literature on estimated use tax compliance on B2B sales, noting that credible estimates ranged as high as nearly 100%, to figures somewhat higher than half that rate. The 65% used by the Tennessee researchers thus falls clearly towards the lower range of all percentages cited. The most thorough study was conducted by State of Washington's treasury department, and found that businesses remitted use tax at a rate in the middle of this range -- about 85%.

The reasons for high B2B tax collection compliance are straightforward. Businesses are much more likely than consumers to be audited, either by their own external auditors or by the government, and they usually enjoy significant economies of scale in record-keeping and tax-filing. Many also maintain complete accounting departments or employ professional bookkeepers.

Table 3 provides an updated and more accurate assessment of the size and composition of B2B sales within total ecommerce, and their impact on un-remitted use taxes. After carrying forward the total amount of B2B ecommerce sales in line 1, which is categorized somewhat differently from Department of Commerce data, treating services as B2B and excluding the "double-counting" of interplant transfers. This base was then used to ascertain the amount exempt arising from original manufacturing or services in line 2 (recognizing that use and sales taxes are levied exclusively on end consumption) Line 3 reports the residual, taking the value of B 2B wholesale sales (again, net of inter-plant transfers without transfer of title.) We then exclude EDI sales, where, as mentioned above, title is not taken or end consumption sales incur nexus when remote sellers use the purchaser's proprietary network. This exclusion together with auto sales (as requiring proof use tax compliance for registration purposes) yields the amount of B2B Internet commerce (line 6) which is adjusted to exclude sales in states where there is no sales tax (line 7).

Finally, in lines 8 and 10, we accept the University of Tennessee's 6.4% average state and local sales tax rate, and use the State of Washington's estimate of 85% compliance, as the most credible estimate currently available in the literature.[2] These yield the total tax liability and ascertain the portion which is remitted by purchasers, leaving the actual value which could accrue to states in line 12.

Table 3: Calculation of Unremitted Tax from B2B Ecommerce

		Actual	Projected

[2] General Accounting Office (2000), *Sales Taxes -- Electronic Commerce Growth Presents Challenges: Revenue Losses Are Uncertain.*

		2005	2006	2007	2008
1	Total B2B Ecommerce				
2	Of which: Exempt B2B Ecommerce				
3	B2B non-exempt Ecommerce	$ 410.0	$ 529.5	$ 590.1	$ 657.8
4	Of which: EDI Sales	$ 281.0	$ 358.9	$ 400.1	$ 445.9
5	B2B Internet Auto Sales **	$ 67.0	$ 85.8	$ 95.7	$ 106.6
6	Remaining B2B Internet Sales	$ 62.0	$ 84.7	$ 94.4	$ 105.2
7	Other Internet B2B in Sales Tax States	$ 60.5	$ 82.6	$ 92.1	$ 102.6
8	Average sales tax rate: 6.4%				
9	Sales Tax Incurred	$ 3.87	$ 5.29	$ 5.89	$ 6.57
10	B2B Compliance Rate	85%			
11	Taxes Remitted By B2B Purchasers	$ 3.3	$ 4.5	$ 5.0	$ 5.6
12	B2B Taxes Unremitted By Purchasers	$ 0.6	$ 0.8	$ 0.9	$ 1.0

* States impose taxes almost exclusively on goods that represent final demand, i.e. are for final use by the end-purchaser. Thus, goods sold by manufacturers to other manufacturers or to wholesalers who do not take title can normally be regarded as entirely tax exempt. Similarly, sales by do not normally involve goods, and so the value of transactions in this category can also be treated as tax exempt for both sales and use taxes. For all these reasons, sales and use taxes fall on only a small portion of business to business sales.

** Tax compliance for auto sales is practically 100% because of vehicle registration requirements.

Source: US Dept of Commerce Census Bureau E-Commerce Report 2007; authors' projections based on historical growth rates for prior three years

III. B2C SALES: THE IMPACT OF MULTICHANNEL SELLERS

Not only did the Tennessee study greatly understate the proportion of sales arising from B2B ecommerce, by the same token, it necessarily overstated the size and impact of B2C ecommerce. But even correcting for the proper volume of B2C ecommerce, as is done in Table 4, the Tennessee study greatly underestimated the proportion of ecommerce sales by multi-channel sellers, *i.e.*, those with physical, as well as online, stores. There are two reasons why, at least in hindsight, the relevant Tennessee estimates are so flawed.

First, the so-called "dot-com bust" of early this decade put many of the then-new, pure-play online sellers out of business. At the time of the Tennessee study, the vast majority of online sales were by these newcomers. No longer is this true; as any examination of the Internet Retailer's annual listing of the top few hundred sellers online, only a handful are pure-play online operations, with this proportion dropping steadily, as more traditional brick and mortar retailers acquire a significant retail presence.

Second, and even more importantly, many of the largest and best-known offline retail stores had, at the time of the Tennessee study, established their online operations as separate subsidiaries in order to reposition themselves in the minds of investors interested in high-tech retailing. As a result, these retailers assumed that, as distinct legal entities with no integration into traditional retail networks, their online operations lacked sales tax nexus even in the states where the parent company had physical stores. Thus, they thought, they did not have an obligation to collect taxes on sales anywhere but where the online entity itself possessed a physical presence – such as its headquarters.

Within just a few years, however, many retailers began folding their online and offline together, and a tax amnesty deal was struck. Most of the top online stores now belong to retail giants, such as Wal-mart, and are collecting sales tax in all states where the parent has a physical store.

These two factors – the demise of the pure-play online sellers and rise of single-entity multi-channel retailers – have vastly increased B2C tax collection rates beyond what the Tennessee authors observed in the marketplace of in 2000-01. What is less defensible, of course, is that their estimates have not been updated to reflect these tectonic shifts. Table 4 summarizes the effect of these factors as well as the estimated effect of sales tax exemptions (for food, pharmaceuticals, children's' clothing) and sales of automobiles where remittance of use-tax is virtually 100%.

Table 4 follows a similar logic to that used above for B2B sales, with the exception that for B2C, the Census Bureau's retail e-commerce data is provided more frequently and is more up to date; and though lacking the greater detail of their annual survey data, can be used to validate actual top line values through 2006; component values are derived from annual reports as far as 2005 and are projected forward based on historical trends.

As with the B2B table, the calculation shown below excludes auto sales as automatically requiring proof of use tax compliance for the autos to be registered and used. Then, in line 6, we exclude some 10% of sales as un-taxed by states, accepting the rather conservative estimate by the Tennessee study. Then, in line 9, we exclude sellers with nexus, using a proportion derived from the E-Commerce reports' data on sales by non-store retailers vs. retailers with stores, even though many such non-store retailers actually have a multiple-jurisdiction retail presence – just not sufficient to be so categorized by the Census Bureau. A *de minimus* voluntary tax compliance rate of about 1% is applied to the value of sales tax incurred on these purchases.

Table 4: B2C Ecommerce

		Actual	Projected		
	B2C Ecommerce	**2005**	**2006**	**2007**	**2008**
1	**Retail E-Commerce--All States**	**$ 93.0**	**$ 114.0**	**$ 137.0**	**$ 163.7**
2	Auto Sales	**$ 17.0**	$ 22.0	$ 27.9	$ 35.2
3	Auto Sales Percent	18.3%	19.3%	20.4%	21.5%
4	**Other Internet**	**$ 76.0**	**$ 92.0**	**$ 109.1**	**$ 128.5**
5	**Other Internet –Sales Tax States**	**$ 74.1**	**$ 89.7**	**$ 106.4**	**$ 125.3**
6	% Exempt B2C Sales	10.4%	10.5%	10.6%	10.7%
7	Amt of Exempt B2C Sales	**$ 9.7**	$ 12.0	$ 14.5	$ 17.5

8	**Non-Exempt B2C**	**$ 64.4**	**$ 77.7**	**$ 91.9**	**$ 107.8**
9	Remote Sellers w/nexus	$ 19.3	$ 24.7	$ 31.0	$ 38.6
10	Pure play Remote Sellers	$ 45.1	$ 53.0	$ 60.9	$ 69.2
11	**Average sales tax rate: 6.4%**				
12	**B2C Sales Tax Incurred**	**$ 2.9**	**$ 3.4**	**$ 3.9**	**$ 4.4**
13	B2C Compliance Rate	0.75%	0.89%	1.02%	1.16%
14	**Taxes Unremitted By Consumers**	**$ 2.9**	**$ 3.4**	**$ 3.9**	**$ 4.4**

Source: US Dept of Commerce Census Bureau E-Commerce Report 2007; authors' projections based on historical data

IV. CONCLUSION

The 2000-01 Tennessee study vastly overstated currently uncollected sales/use tax revenue. As can be seen in Table 5, summing the calculations of B2B and B2C sales and taxes owed based upon the most comprehensive and up to date Department of Commerce data now indicate that nationwide only $3.5 billion was likely still outstanding from remote sales in 2005, and that this amount will reach only $4.8 billion in 2007, and $5.4 billion in 2008.

Table 5: Total Unremitted tax on Ecommerce Sales ($billions)

	2005	2006	2007	2008
B2B Taxes Uncollected	$ 0.6	$ 0.8	$ 0.9	$ 1.0
B2C Taxes Uncollected	$ 2.9	$ 3.4	$ 3.9	$ 4.4
Total Taxes Uncollected	**$ 3.5**	**$ 4.2**	**$ 4.8**	**$ 5.4**

Source: US Department of Commerce and Author's calculations, described herein.

As can further be seen from Table 6, these figures based on up to date Commerce Department data are but a fraction of the $45 billion originally projected by the 2001 University of Tennessee study for 2006 – an amount that states still find it in their interest to cite, even though it was a figure the Tennessee authors subsequently revised downwards to $19 billion – and even this amount we now recognize to be almost five times too high.[3]

Table 6: Comparison to 2000-01 Tennessee Studies

UNCOLLECTED ECOMMERCE SALES TAX	2006
Tennessee Study 2000 (based on Forrester Data)	**$45.4**
Partially Corrected Tennessee Study 2001 (based on Forrester Data)	**$19.2**
DMA Study 2007 (based on US Commerce Dept. Data)	**$4.2**

Of course, states are less concerned with national totals than the amounts that would accrue to them. To see the relevant impact on individual states, Table 7 provides a side by side comparison of the estimated amounts of unremitted use tax, taking the totals from the original and partially corrected University of Tennessee studies, and the present analysis of Dept. of Commerce data, and apportioning to individual taxing states on the basis of state share of total US GDP.

[3] Bruce and Fox (2001) p. 6

Table 7: State By State Comparison Of Unremitted Use Tax

	2006				
State/Data Source	State GDP as % of GDP for all Sales Tax States	Original University of Tennessee	Revised University of Tennessee	DMA Analysis of Census Bureau Data	If SSTA only/Join SSTA
Alabama	1.3%	$604.3	$256.67	$56.15	$10.9
Arkansas	1.1%	$488.0	$207.27	$45.34	$8.7
Arizona	1.8%	$799.2	$339.45	$74.25	$14.8
California	13.2%	$5,952.0	$2,528.04	$553.01	$171.6
Colorado	1.5%	$686.4	$291.54	$63.77	$12.5
Connecticut	1.4%	$648.9	$275.61	$60.29	$11.8
D.C.	0.3%	$123.1	$52.29	$11.44	$2.1
Florida	7.1%	$3,214.0	$1,365.11	$298.62	$75.0
Georgia	3.4%	$1,517.8	$644.67	$141.02	$30.3
Hawaii	0.8%	$359.2	$152.57	$33.37	$6.3
Iowa	0.8%	$372.3	$158.13	$34.59	$6.3
Idaho	0.3%	$151.5	$64.35	$14.08	$2.6
Illinois	4.0%	$1,795.3	$762.53	$166.80	$36.8
Indiana	1.6%	$728.5	$309.42	$67.69	$12.3
Kansas	1.0%	$451.5	$191.77	$41.95	$7.6
Kentucky	1.2%	$535.5	$227.45	$49.75	$9.0
Louisiana	2.2%	$1,008.1	$428.18	$93.66	$19.1
Massachusetts	1.5%	$683.0	$290.10	$63.46	$12.5
Maryland	1.5%	$664.3	$282.15	$61.72	$12.1
Maine	0.3%	$146.4	$62.18	$13.60	$2.5
Michigan	3.8%	$1,696.2	$720.44	$157.60	$28.7
Minnesota	2.0%	$920.6	$391.01	$85.53	$15.6
Missouri	2.0%	$884.1	$375.51	$82.14	$16.5
Mississippi	1.0%	$462.8	$196.57	$43.00	$8.2
North Carolina	2.2%	$1,010.9	$429.37	$93.92	$17.1
North Dakota	0.2%	$87.6	$37.21	$8.14	$1.5
Nebraska	0.5%	$238.7	$101.39	$22.18	$4.0
New Jersey	2.5%	$1,150.0	$488.45	$106.85	$19.4
New Mexico	1.0%	$440.2	$186.97	$40.90	$7.8
Nevada	1.0%	$441.7	$187.61	$41.04	$7.9
New York	7.9%	$3,569.2	$1,515.98	$331.62	$85.8
Ohio	3.3%	$1,502.2	$638.04	$139.57	$29.9
Oklahoma	1.5%	$670.6	$284.83	$62.31	$11.3
Pennsylvania	3.3%	$1,503.4	$638.55	$139.68	$29.9

Rhode Island	0.3%	$124.5	$52.88	$11.57	$2.1
South Carolina	1.2%	$525.0	$222.99	$48.78	$9.4
South Dakota	0.3%	$133.4	$56.66	$12.39	$2.3
Tennessee	2.7%	$1,242.8	$527.86	$115.47	$24.1
Texas	8.8%	$3,957.0	$1,680.69	$367.65	$98.2
Utah	0.8%	$359.0	$152.48	$33.36	$6.3
Virginia	1.8%	$817.0	$347.01	$75.91	$1.2
Vermont	0.2%	$71.7	$30.45	$6.66	$1.2
Washington	3.2%	$1,427.3	$606.23	$132.61	$28.2
Wisconsin	1.6%	$721.5	$306.45	$67.04	$13.2
West Virginia	0.5%	$232.4	$98.71	$21.59	$3.9
Wyoming	0.2%	$85.2	$36.19	$7.92	$1.5
TOTAL	**100%**	**$45,204.3**	**$19,200**	**$4,200.0**	

It is also possible – though highly unlikely – that Congress might be persuaded to alter the law on nexus only for those states that are fully compliant with the State Streamlined Sales Tax Agreement (SSTA). Thus for comparative purposes, the last column of table 7 reports the portion of unremitted use tax accruing to states that are currently fully certified (2007) members of SSTA, or if they are not, the amount that would accrue if they were the next state to join this group. (Note: state values in this column assume each state was the incremental addition to the original SSTA members, so will not sum).

BRANN & ISAACSON LLP
ATTORNEYS AND COUNSELORS AT LAW
184 MAIN STREET
P.O. BOX 3070
LEWISTON, MAINE 04243-3070
(207) 786-3566
TELECOPIER (207) 783-9325
E-MAIL ADDRESS: lawyers@brannlaw.com

IRVING ISAACSON
GEORGE S. ISAACSON
MARTIN I. EISENSTEIN
MARTHA E. GREENE
DAVID W. BERTONI
PETER D. LOWE
BENJAMIN W. LUND
DANIEL C. STOCKFORD
PETER J. BRANN
KEVIN R. HALEY
DANIEL A. NUZZI
KAREN P. O'SULLIVAN
MATTHEW P. SCHAEFER
JULIE A. BRADY
JEFFREY B. HERBERT

LOUIS J. BRANN-1948
PETER A. ISAACSON-1980

August 4, 2000

Frank Shafroth
National Governors Association
Streamlined Sales Tax Project
444 N. Capitol Street, NW, Suite 425
Washington, DC 20001-1538

RE: Direct Marketing Association - Sales/Use Tax Reform Proposals

Dear Frank:

On behalf of the Direct Marketing Association, please find enclosed several sales/use tax reform proposals which it believes should be incorporated into any interstate compact designed to simplify and harmonize the existing morass of disparate state sales/use tax laws. DMA recognizes that the existing system arose in an economic environment significantly different than that which now confronts interstate marketers. Both states and multistate merchants are now at an historical juncture where their combined efforts, along with those of Congress, could result in a substantially reformed sales/use tax system designed for the commercial and revenue needs of the 21st Century.

It is my understanding that the NGA's Streamlined Sales Tax Project will explore possibilities for substantial reform of state and local sales/use taxes, and that the results of those efforts will form the basis for further discussions with industry representatives and appropriate congressional committees. The Direct Marketing Association is prepared to be an active participant in this process and to engage in a constructive dialogue with state and local government officials to re-engineer the existing tax system to better serve the interests of both government and electronic commerce merchants.

I assume that you are the appropriate contact person for the Streamlined Sales Tax

BRANN & ISAACSON
ATTORNEYS AND COUNSELORS AT LAW

Frank Shafroth
Page 2

Project. After you and the other government representatives have had an opportunity to review the enclosed proposals, I would appreciate your contacting me and advising how DMA can best engage in direct discussions with the state representatives on these issues and work together toward a simplified sales/use tax system. I look forward to your response.

Very truly yours,

BRANN & ISAACSON, LLP

George S. Isaacson

GSI/dmg

Enclosure

Tax Reform Proposals
For Submission To States' Streamlined Sales Tax Project

I. TAX RATES
   A. Rate Structure
      1. One tax rate per state for all commerce.
   B. Frequency Of Rate Changes
      1. 120 day advance notice of rate changes.
      2. Rate changes only on January 1 and July 1.

II. TAX BASE
   A. Greater Uniformity Of Tax Base
      1. Common definitions of taxable and exempt products.
      2. Commitment among Participating States to adopt a uniform tax base within 10 years.
      3. Elimination of tax on shipping and handling charges.

III. TAX FORMS
   A. Standardized Forms
      1. Single multi-state registration form.
      2. Single multi-state spreadsheet-style remittance form.
      3. Standard resale certificate (no state modifications or varying certificate numbers).
      4. Standard exemption certificate and common database of exempt organizations.

IV. CENTRALIZED ADMINISTRATION
   A. Centralized Filing For Each Multi-State Vendor
      1. One central registration point applicable to all Participating States.
      2. One spreadsheet-style remittance report covering all Participating States.
   B. Administrator State - Each Multi-State Vendor Must Select A Participating State As Its Administrator State
      1. Administrator State is the filing point for all registrations and remittances.
      2. Administrator State authorized to conduct audits of the multi-state vendor on behalf of all Participating States.
   C. Audits
      1. A single audit on behalf of all Participating States is conducted by the Administrator State (unless the vendor requests to be audited by each individual taxing state).
      2. Audits will be conducted no more frequently than once every two years, unless there is reasonable basis to believe that there is fraud or financial insolvency.
      3. Each Participating State must give a multi-state vendor the option of submitting a protested tax assessment to a mediation-arbitration process in lieu of pursuing administrative appeals and judicial review in the individual taxing state.

V. LIMITATION ON VENDOR LIABILITY
   A. A retailer shall not be liable to a taxing state for uncollected use taxes if the customer fails to remit to the retailer the applicable tax amount in the following circumstances:
      1. Customers paying by credit card:
         a) The retailer determined the applicable tax by using tax collection software certified by the state.

2. Customers paying by check or money order:
   a) The retailer provided a general notice in its advertising that applicable use tax should be included with payment.

B. Uniform Bad Debt Provisions

VI. VENDOR DISCOUNT
   A. Reasonable Reimbursement Of Retailer Collection Costs
      1. The vendor discount should be increased and standardized among the Participating States to reflect the actual average costs of collection to retailers.
      2. Increased vendor discount should be applicable to all retailers.
      3. Joint state government-retail industry panel should be established to determine the real collection costs incurred by vendors (perhaps by different categories of retailers), with an on-going responsibility to recommend adjustments in vendor discounts as cost elements change over time.

VII. SOURCING
   A. Gift Transactions
      1. In third-party donee transactions, no use tax should be imposed unless the purchaser and the donee are located in the same state.

VIII. CONSUMER PRIVACY
   A. Limits On Demands For Consumer Information
      1. States should not be allowed to require vendors to obtain any information from consumers other than that which is necessary for completion of the sales transaction.
   B. Limits On Use Of Consumer Information
      1. States may not use personally identifiable consumer-provided information for any purpose other than determination of use tax liabilities.
      2. States will conform to privacy assurance standards and procedures (both as to audit practices and data storage) established by an independent certifying agency which will annually report on state compliance with the established standards.

IX. *DE MINIMIS* EXCEPTION FOR REMOTE SELLERS
   A. National Sales By A Remote Seller Before Being Subject To Collection Duties
      1. Ten million dollars (CPI adjusted based on Year 2000).
   B. State Sales By A Remote Seller Before Being Subject To Collection Duties For That State
      1. Five hundred thousand dollars (CPI adjusted based on Year 2000).

X. ADOPTION OF SIMPLIFIED AND UNIFORM LAW BY CRITICAL MASS OF STATES
   A. Number Of States
      1. 30, plus
   B. Percentage National Population
      1. 70% of national population must reside in those states.

XI. FEDERAL COURT JURISDICTION REGARDING UNCONSTITUTIONAL STATE TAXATION
   A. Tax Injunction Act
      1. Amend Tax Injunction Act to grant federal court jurisdiction over cases in which it is alleged that a state tax law or practice violates the U.S. Constitution.

B. Recovery of Attorney Fees

1. As in other cases where a plaintiff proves a state violation of a federally-guaranteed right, permit taxpayers in actions alleging a violation of their constitutionally protected rights to collect their attorney fees if successful in the litigation.

ANNOTATIONS FOR TAX REFORM PROPOSALS

I.A.1 - Multiple state and local tax rates are burdensome for all multi-state retailers, including for those which have nexus in numerous states (many DMA members fall into this category), and the great variety of rates are confusing to consumers. True tax simplification must begin by eliminating the ever-expanding number of tax jurisdictions. This was a reform measure unanimously agreed upon during the NTA Project.

I.B.1 and 2 - Catalog companies need long lead times because of lay-out and printing requirements to change their catalog copy and order forms regarding customer tax obligations.

II.A. 1 and 2 - The disparate tax base among various states is one of greatest causes of customer confusion and vendor compliance error. States should move towards substantially greater uniformity in their tax bases.

II.A.3 - The disparity among the states regarding taxation of shipping and handling charges is especially confusing to consumers, and it forces catalog companies to develop complex order forms (which look more like tax forms). As a service, delivery charges should be eliminated from the tax base.

III.A.1,2,3 and 4 - Standardization of forms is one of the easiest and least painful steps for the states to take.

IV.A. 1 and 2 - Centralized filing, with only one compliance point of contact for each retailer, is a simple and logical step towards administrative simplificaton.

IV. B. 1 and 2 - An Administrator State or "base state" system substatially reduces the administrative complexity of tax administration for multistate retailers. It has worked well for the states and the Canadian Provinces in regard to the state and provincial fuel tax obligations of interstate and international trucking firms. To the extent that states expect interstate marketers to be able to comply with a variety of state use taxes, then it is certainly appropriate to expect that the revenue departments of the Participating States will be able to administer the system (especially if simplified) on behalf of their sister states.

IV.C.1 and 2 - A single audit by the Administrator State on behalf of all Participating States can reduce the time and expense of coping with multiple use tax audits. Similarly, by limiting the frequency of audits (but permitting audits well within each state's statute of limitations), the burdens and interuptions of multiple state tax audits is reduced.

IV.C.3 - Forcing an out-of-state retailer to hire local counsel and proceed through the arcane administrative and appeal procedures of a foreign jurisdiction is one of the principal concerns of interstate retailers regarding collection of state use taxes. An elective mediation process, followed by binding arbitration of taxpayer protests, would be a quick and cost-efficient means to allow remote sellers to obtain a fair resolution of their contested assessments. Currently, many state administrative and judicial appeal procedures are simply too slow and too expensive to permit a remote seller to challenge the assessment.

V.A.1 - Changes in tax rates and taxable products present the risk that vendors will err in the calculation of applicable taxes. Certified tax collection software reduces that risk and its economic consequences.

V.A.2 - In contrast to a traditional consumer transaction conducted over a sales counter, in the remote sales context, a customer may not necessarily include the applicable sales tax in his payment, despite being asked to do so by the vendor. This is especially problematic where payment is made by check and the customer errs in his self-calculation of the tax. In those circumstances, post-sale collection of the tax is prohibitively expensive for the retailer.

V.A.B - A retailer should not be obligated to remit use tax to a state on the full value of a customer order when the retailer does not collect full payment from its customer. Currently, there is no consistent treatment of bad debts among the states. Retailers are often left holding the bag on state taxes. Similarly, on installment sales, the tax should be remitted to the state on a proportional basis as payments are received by the retailer from the consumer.

VI.A. 1, 2, and 3 - There is no policy justification for retailers being forced to subsidize the states for the expense of collecting use taxes from state residents. If states believe that retailer-collection of use taxes is the most efficient means of collecting those taxes (as compared to efforts by the states to collect the tax directly from their citizens), then the states should reimburse retailers for all the costs they incur in administering the tax collection system on behalf of the states. Indeed, in the states' "Zero Burden Proposal" before the Advisory Commission On Electronic Commerce, it was stated that the states should assume all the expense of use tax collection administration.

VII.A.1 - Many remote consumer sales involve situations where the buyer is not the recipient of the product being delivered (e.g., holiday season gifts sent to family members). Where the buyer and the donee are located in different states, there should be no use tax imposed on the transaction. (The buyer is not "using" the product in his home state, so no tax should be imposed by that state; and the donee is not the purchaser of the product, so the donee state should not impose a tax on the recipient of a gift.)

VIII.A.1 and B.1 - A reasonable de minimis threshold will minimize the deterrent effect of use tax collection on new business entering the electronic commerce marketplace.

IX.A.1 and B.1 - A reformed sales/use tax system designed to acieve substantial simplification and greater uniformity does little good if it is not widely - indeed, almost universally - adopted by the states.

X.A.1 - If state tax laws are to be given expanded national scope, then the national court system should be given authority to hear claims that the administration of those tax laws violates the federal constitution. This is especially important where the taxpayer is not a resident of the state imposing the tax obligation.

X.B.1 - Statutory provisions for the recovery of attorney fees are not only intended to reimburse successful plaintiffs for the litigation costs they incurred; such laws are also intended to deter parties (including states) from violating the constitutional rights of individuals and businesses. Any expansion of state tax authority to remote sellers carries a significant risk of new violations of constitutional law. (Indeed, case precedent is already replete with examples of state tax administrators violating the constitutional rights of taxpayers.) The threat of paying a successful litigant its attorney fees would be an important constraint on state revenue department abuse of taxpayer rights.

XI.A.1 - Many aspects of electronic commerce are instantaneous and anonymous, including some forms of payment. The growth and development of electronic commerce should not be impeded by state revenue department demands for the collection of consumer information which goes beyond that which is necessary for completion of the transaction.

XI.B.1 - American consumers are entitled to strict procedures and ironclad assurances that the information obtained by government officials will only be use for the intended purposes and not inappropriately disseminated or shared with other government agencies or private entities.

BRANN & ISAACSON

ATTORNEYS AND COUNSELORS AT LAW

184 MAIN STREET
P.O. BOX 3070
LEWISTON, MAINE 04243-3070
(207) 786-3566
TELECOPIER (207) 783-9325
WEB PAGE: http://www.brannlaw.com

IRVING ISAACSON
GEORGE S. ISAACSON
MARTIN I. EISENSTEIN
MARTHA E. GREENE
DAVID W. BERTONI
PETER D. LOWE
BENJAMIN W. LUND
DANIEL C. STOCKFORD
PETER J. BRANN
KEVIN R. HALEY

DANIEL A. NUZZI
MATTHEW P. SCHAEFER
REGAN M. HORNNEY
LYNN B. GELINAS
DAVID SWETNAM-BURLAND
DAVID T. SLATERY
ANNE NACINOVICH*
BARBARA J. SLOTE
STACY O. STITHAM

Portland Conference Office
148 MIDDLE STREET
SUITE 502
PORTLAND, MAINE

LOUIS J. BRANN 1948
PETER A. ISAACSON 1980

*ADMITTED IN NEW YORK ONLY

September 12, 2007

VIA EMAIL & U.S. MAIL

Scott Peterson
Executive Director
Streamlined Sales Tax Governing Board, Inc.
4205 Hillsboro Pike
Suite 305
Nashville, TN 37215

RE: Alternative Sourcing Proposal

Dear Scott:

As you know, I am tax counsel for the Direct Marketing Association ("DMA"), the nation's largest trade organization representing remote sellers, many of whom collect and remit use taxes to Streamlined Sales Tax Member States. Please accept this letter as a position statement on behalf of the DMA in opposition to the Alternative Sourcing Proposal which will be considered by the Streamlined Sales Tax Governing Board at its September 19-20 meeting in Kansas City.

My understanding is that the proposal under consideration is to amend Section 310 of the Streamlined Sales and Use Tax Agreement, which currently requires that all Member States use "destination sourcing" (i.e., location of the purchaser where products are delivered) for all sales, both interstate and intrastate. The proposed amendment would abandon the mandatory "destination sourcing" rule and, instead, permit Member States to adopt a two-tiered-optional-rate sourcing protocol. This new optional rate would apply only to the local portion of combined state and local use taxes and would require a Member State to apply "origin sourcing" to all intrastate sales, while requiring adoption of a combination rate for interstate sales, which could be as much as the sum of the state rate plus the highest local rate applicable within the state, irrespective of the actual tax rate in effect where the purchaser is located.

The DMA is strongly opposed to this amendment, which it believes is both confusing and discriminatory. A principal objective of the Streamlined Sales Tax Project was to achieve simplicity, consistency and greater uniformity in the substance and administration of state sales and use tax laws. A single protocol for sourcing taxable transactions was critical to achieving that goal. Now, seven years after the launch of the streamlining project, a change in the SSUTA that would permit Member States to adopt different sourcing rules for state level taxes (destination sourcing) and local level taxes (origin sourcing) would be a major step backwards. Such a departure from uniform sourcing standards would cause confusion and serve no valid tax policy purpose.

Most significantly, the proposed amendment creates a distinction between the treatment of intrastate commerce and interstate commerce. This is the very evil that the Constitution's Commerce Clause (Art. I, § 8, cl. 3) was intended to prevent. The Supreme Court has been vigilant and adamant in barring such discriminatory treatment. In *Associated Industries of Missouri v. Lohman*, 511 U.S. 641 (1994), a unanimous Supreme Court concluded that Missouri's statewide uniform use tax violated the Commerce Clause by discriminating against interstate commerce in those localities where the uniform use tax exceeded the local sales tax rate. Writing for the Court, Justice Thomas opined:

> Missouri's use tax scheme, however, runs afoul of the basic requirement that, for a tax system to be "compensatory" the burdens imposed on interstate and intrastate commerce must be equal. ... But in Missouri, whether the 1.5% use tax is equal to (or lower than) the local sales tax is a matter of fortuity, depending entirely upon the locality in which the Missouri purchaser happens to reside. Where the use tax exceeds the sales tax, the discrepancy imposes a discriminatory burden on interstate commerce. ... The resulting disparity is incompatible with what we have termed the 'strict rule of equality ...'[1]

The elimination of confusing, cumbersome and convoluted tax schemes was an overriding objective of the Streamlined Sales Tax Project. This latest proposed convolution, however, which calls for different sourcing schemes at the state and local levels, and different treatment of intrastate and interstate commerce, is counter-productive and would undermine foundational principles of tax simplification for businesses and consumers. True tax reform can best be accomplished by limiting each Member State to one tax rate per state for all commerce. The DMA has consistently supported such tax reform, and it urges the Governing Board to reject

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[1] The Alternative Sourcing Proposal's provision that a purchaser can seek a refund or a credit from the state for any overpayment of taxes does not cure the constitutional defect. The initial facial discrimination is constitutionally fatal, and, moreover, it is neither practical nor fair to impose on consumers the added burden of applying for refunds to state revenue departments for the relatively small individual transaction amounts to which they may be entitled.

the Alternative Sourcing Proposal and, instead, adopt the one rate per state rule that the DMA has long advocated.

Thank you for the Governing Board's consideration of these comments.

Very truly yours,

BRANN & ISAACSON

George S. Isaacson

GSI/dmg

Ms. SÁNCHEZ. Thank you so much.

At this time, I would invite Mr. Rauschenberger to begin.

TESTIMONY OF STEVEN J. RAUSCHENBERGER, RAUSCHENBERGER PARTNERS, LLC, ELGIN, IL, ON BEHALF OF THE NATIONAL CONFERENCE OF STATE LEGISLATURES

Mr. RAUSCHENBERGER. Good afternoon—or good morning still, I guess. I appreciate the opportunity to be here.

I am Steve Rauschenberger, past president of NCSL, a former assistant Republican leader in the Illinois State Senate, third generation retailer and an accountant by education. The National Conference of State Legislatures is a bipartisan national organization representing every State legislature from all 50 States and our Nation's commonwealths, territories, and possessions and the District of Columbia.

I am pleased to have the opportunity to appear before you today in support of H.R. 3396. But I have to tell you this. My spending 15 years in the Illinois Senate, much of it in hearing rooms and chairing the appropriation committee for 10 years of testifying in Congress on four separate occasions in the past, I am nervous today because today's it is not just a good idea I am representing. I am representing the work of hundreds of people who have devoted literally thousands of hours and effort and compromise to try to figure out a way to bring the States together.

I am representing the active involvement of 35 States through their legislative leaders and the executive branches. More than 37 States have taken action in both chambers or through executive order to participate in this process. I am commenting in favor of what I think is the most important piece of legislation to sustain, to reform, and stabilize our world-admired system of federalism that 50 sovereign States and an indivisible union that I have ever been involved with.

So I am a little nervous. It is because I care a great deal about this issue. And it is much more important than I think people realize.

You have heard a lot about the substance and the structure. Maybe, you know, I can touch on some of the soft balls that need to be added out of the ballpark a little bit.

What this bill in combination with the streamlined sales tax agreement does is it levels the playing field so businesses that play by the rules that have been traditional retailers are treated equally with everybody using cyber to a sort. I am in favor of Internet retail. I think it is a wonderful thing. It expands the assortment. It strengthens the American economy.

But we should have a tax system that treats all transactions of like transactions in similar ways from a tax point of view. The streamlined sales tax together with this bill provides stability for State and local revenues. So whether there is a treasure hidden somewhere under the sand or not, equity doesn't require justification. I mean, that is what our tax laws should be pursuing.

This provides both administrative and liability relief for businesses that adopt the modernized sales tax. States accept the responsibility to compensate retailers for the cost of collection. The bill includes protections for small retailers who have sales of less than $5 million over the Internet so they don't have to come into compliance with this.

It retains and protects State sovereignty and tax competition between the jurisdictions, which is something we all believe in. It retains local governments' rights its States' granted to impose sales taxes on their own. And it recognizes in a way other things don't the political realities of adopting reform in a complex economy, in a complex country under our laws.

Taxes are never popular. However, if State and local governments are to have the necessary resources to provide education and homeland security and public safety, then we need to maintain their ability to levy taxes. In surveys across the Nation, the tax that is least disliked is, surprisingly, the sales tax.

When you think about it, sales taxes when they were first imposed in the 1930's customers bought goods from local merchants. There were very few remote sellers.

In the 1970's and the 1980's we saw more goods being sold by remote mail order sellers and without collection of tax. This was adjudicated in the court cases of Bellis, Hess in 1967 and reaffirmed by the *Quill* decision. What we have tried to do rationally since 1999 is to pull together legislative leaders and business leaders, executive branch, tax commissioners and try to come up with a solution to the change in commerce that adopts State laws.

This is not replacement of sales tax law in the 50 States with some new model act, which maybe the UCC would be. It is a convergence of State policy. It is complicated necessarily because it is designed to protect and to defend State sovereignty at the same time it provides local options and local resources.

I am going to wind up real quick because I can tell you lots. I could do this for about 45 minutes and probably bore you to death. But, you know, let me end by reminding you. You know, it is wonderful that the uniform commercial code went to the uniform group on laws. I think it took about 40 years from the beginning of the adoption of that to its last adoption.

We are in an Internet age. And the challenge is are States going to be able to conform and to change and adapt to the changing environment, whether it is our taxes, whether it is a regulation of professions, whether it is a regulation of insurance.

This is a fragile flower of reform that has been brought along by people working very hard. I hope you treat it delicately. I hope you treat it thoughtfully. I couldn't disagree more with some of the representations from the previous distinguished speaker. And if we get to him in questions, I would be happy to try to knock some more out of the park.

[The prepared statement of Mr. Rauschenberger follows:]

PREPARED STATEMENT OF STEVE RAUSCHENBERGER

NATIONAL CONFERENCE *of* STATE LEGISLATURES

The Forum for America's Ideas

TESTIMONY OF
STEVEN RAUSCHENBERGER
PAST PRESIDENT
NATIONAL CONFERENCE OF STATE LEGISLATURES

ON BEHALF OF THE
NATIONAL CONFERENCE OF STATE LEGISLATURES

REGARDING
H.R. 3396
THE SALES TAX FAIRNESS AND SIMPLIFICATION ACT

BEFORE THE
SUBCOMMITTEE ON ADMINISTRATIVE AND COMMERCIAL LAW
COMMITTEE ON THE JUDICIARY
UNITED STATES HOUSE OF REPRESENTATIVES

DECEMBER 6, 2007

SUBCOMMITTEE ON ADMINISTRATIVE AND COMMERCIAL LAW
COMMITTEE ON THE JUDICIARY
UNITED STATES HOUSE OF REPRESENTATIVES

DECEMBER 6, 2007

TESTIMONY OF THE HONORABLE STEVEN RAUSCHENBERGER
PAST PRESIDENT
NATIONAL CONFERENCE OF STATE LEGISLATURES

Chairwoman Sanchez, Ranking Member Cannon and members of the Subcommittee on Administrative and Commercial Law, I appreciate the invitation to testify before you today on behalf of the National Conference of State Legislatures (NCSL). I am Steven Rauschenberger, past president of NCSL and the former Assistant Republican Leader of the Illinois State Senate. The National Conference of State Legislatures is the bi-partisan national organization representing every state legislator from all fifty states and our nation's commonwealths, territories, possessions and the District of Columbia.

I am pleased to have the opportunity to appear before you today in support of H.R. 3396, the Sales Tax Fairness and Simplification Act, as introduced by Representative William Delahunt a member of this Subcommittee and my good friend from Illinois, Representative Ray LaHood.

Ever since 2002, state legislators through NCSL have adopted resolutions calling upon the Congress of the United States to consider and approve federal legislation that would give a state authority to require all sellers (except those qualifying for the small business exception) to collect the state's sales taxes if that state is in compliance with the Streamlined Sales and Use Tax Agreement. Let me make this very clear, state legislators are not advocating any new or discriminatory taxes on electronic commerce. We desire, however, to establish a streamlined sales and use tax collection system that is seamless for sellers in the new economy and respects the sovereignty of state borders.

The new economy or if you prefer, electronic commerce, which is not bound by state and local borders makes it critical to simplify and reform state and local taxes to ensure a level playing field for all sellers, to enhance economic development, and to avoid discrimination based upon how a sale may be transacted. Government can not allow a tax system that was designed for an economy that existed almost 80 years ago, to be the deciding factor as to where our constituents make a transaction.

Sales Tax Popularity

As we all know, taxes are never popular. However, if state and local governments are to provide necessary services, such as education and public safety, then we need to maintain our ability to levy taxes. In surveys of taxpayers as to which tax of all the major federal, state and local taxes they dislike the least, the surprising answer has consistently been the sales tax.

Voters all over the country have approved local sales taxes to pay for sports stadiums, added police protection, land acquisition for open space, and transportation improvements. The taxpayers of the state of Michigan overwhelmingly voted to use the sales tax as opposed to property tax as the major source of revenue for education and then in following years, they have voted to increase the sales tax in order to provide additional funding for education.

The general sales and use tax is the primary consumption tax for state and local governments. In 2005, sales taxes accounted for one-third of state revenues – over $ 311 billion – with the largest percentage of the funds used to finance K-12 education.

Sales Tax and Electronic Commerce

The problem states have with the sales tax is that the tax base keeps shrinking. In the 1930s, when the sales tax was first imposed, consumers bought goods from the local merchant and it was not that difficult for the merchant to collect a few cents on the dollar. Also, most Americans spent very little on services – they spent most of their money on taxable goods. And there were very few "remote sellers."

In the 1970s and 1980s, the share of personal consumption expenditures began to shift from taxable goods to services – things like medical care, health clubs, legal and accounting services. So the sales tax was applied on a smaller and smaller share of tangible products. This was compounded on the goods side by mail order outlets selling goods without collecting sales taxes from their customers – a practice sanctioned by the U.S. Supreme Court in the *National Bellas Hess* case in 1967 and reaffirmed in the *Quill* decision in 1992.

Today, states face a new threat to sales tax revenue, electronic commerce, with the potential to dramatically expand the volume of goods sold to customers without collection of a sales or use tax. The combined weight of the shift to a service based-economy and the erosion of sales tax revenues due to electronic commerce threatens the future viability of the sales tax and the ability of state governments to fund essential services such as education, homeland security and public safety.

According to the Center for Business and Economic Research at the University of Tennessee, in 2003, the estimated combined state and local revenue loss due to remote sales was between $15.5 billion and $16.1 billion. For electronic commerce sales alone, the estimated revenue loss was between $8.2 billion and $8.5 billion. The report from the University of Tennessee further estimates that the revenue loss will grow and that by 2008, the revenue loss for state and local governments could be as high as $33.6 billion, of which it is estimated that $17.8 billion would be from sales over the Internet. (See Table 1)

Table 1

Combined State & Local Revenue Losses
from E-Commerce and All Remote Commerce – 2008

Source: Dr. Donald Bruce & Dr. William Fox, Center for Business & Economic Research
University of Tennessee

State	E-Commerce Loss *(millions)*	All Remote Sales *(millions)*
Alabama	238.7	449.7
Arkansas	190.6	359.2
Arizona	**435.7**	**821.1**
California	**2452.0**	**4620.4**
Colorado	287.8	542.4
Connecticut	266.0	501.2
District of Columbia	48.8	91.9
Florida	**1248.2**	**2351.1**
Georgia	**600.0**	**1130.5**
Hawaii	130.3	245.5
Iowa	141.4	266.4
Idaho	66.3	125.0
Illinois	582.2	1097.0
Indiana	323.6	609.7
Kansas	178.8	336.9
Kentucky	214.6	404.3
Louisiana	409.8	772.2
Massachusetts	**286.4**	**539.6**
Maryland	265.9	501.1
Maine	67.2	126.6
Michigan	**587.3**	**1106.6**
Minnesota	381.2	718.3
Missouri	313.9	591.5
Mississippi	191.9	361.6
North Carolina	**405.9**	**764.9**
North Dakota	34.3	64.6
Nebraska	123.4	232.4
New Jersey	469.9	885.5
New Mexico	140.4	264.6
Nevada	186.6	351.5
New York	1288.4	2427.7
Ohio	**608.6**	**1146.8**
Oklahoma	185.4	349.3
Pennsylvania	585.6	1103.4
Rhode Island	58.5	110.3
South Carolina	209.4	394.5
South Dakota	47.0	88.6
Tennessee	**508.3**	**957.9**
Texas	1634.5	3079.9
Utah	**150.7**	**284.0**
Virginia	294.8	555.4

Vermont	29.1	54.8
Washington	574.6	1082.7
Wisconsin	303.4	571.7
West Virginia	86.6	163.2
Wyoming	38.9	73.3
United States	**17,872.9**	**33,677.8**

State legislators recognize that they have been part of this problem. Over the last 80 years, state and local policymakers have created a confusing, administratively burdensome tax system with very little regard for the compliance burden placed on multi-state businesses. In 1999, NCSL passed a resolution, written by NCSL's Task Force on State and Local Taxation of Telecommunications and Electronic Commerce, which I co-chaired, that acknowledged that states need to simplify their sales and use taxes and telecommunications taxes for the 21st Century. We recognized that we have been a key part of the problem and we accepted the fact that it was our problem to solve.

In our resolution, we formulated a set of seven principles that we used to develop a proposal for simplifying and streamlining state and local sales and use tax collection systems. The overriding theme of those seven principles is competitive neutrality. State legislators from across the country unanimously approved this resolution that declared, **"state and local tax systems should treat transactions involving goods and services, including telecommunications and electronic commerce, in a competitively neutral manner."** The resolution further stipulated, "that a simplified sales and use tax system that treats all transactions in a competitively neutral manner will strengthen and preserve the sales and use tax as vital state and local revenue sources and preserve state fiscal sovereignty."

The Cost of Collection for Sellers

As you are aware, the sales tax is imposed on the customer, not the seller. Sellers determine the sales tax to be collected, collect the tax and remit the tax collected to the state (in four states, Alabama, Arizona, Colorado and Louisiana, sellers also must remit the local portion of the sales tax directly to the local government). Under the current sales tax system, the seller also is liable for any mistakes that might occur due to misinformation from the buyer or even the state. This means that the seller is liable for any uncollected sales tax plus interest and penalties.

A recent national survey commissioned by the Joint Cost of Collection Study, a public / private sector group, and conducted by PricewaterhouseCoopers LLP, has shown that in fiscal year 2003 the total cost to sellers to collect state and local sales taxes was $6.8 billion. This amount was calculated after subtractions for state vendor discounts and retailer float on the sales tax revenues.

The study showed that for fiscal year 2003, retailers selling between $150,000 and $1 million the average cost was 13.47 percent of the sales taxes collected or approximately $2,386; for mid-size retailer, between $1 million and $10 million in sales, the average cost was 5.2 percent or approximately $5,279; and for the larger retailers, over $10 million in sales, the average cost of collection was 2.17 percent or approximately $18,233. It is important to remember that these amounts, including the total cost for all retailers of $6.8 billion, are not reimbursed to the retailer by the state or local government, these costs comes out of the retailer's own pocket.

The burden on retailers to comply with 46 different sales tax systems and the monetary cost to retailers for compliance resulted in the two Supreme Court decisions, cited above, that prohibited a state from requiring an out-of-state seller from collecting sales tax on a purchase made by a resident of the state.

Solution: Streamlined Sales and Use Tax Agreement

Beginning in 2000, state legislators, governors and tax administrators, along with representatives of retailers and others in the private sector, started the process to develop a simpler, uniform and fairer system of sales and use taxation, that removes the burden imposed on retailers, preserves state sovereignty, levels the playing field for all retailers, and enhances the ability of U.S. companies to compete in the global economy. The urgency to develop such a system caused NCSL's Executive Committee to set aside NCSL's rule of non-interference in state legislation and to endorse model legislation committing sales tax states to multistate discussions on developing a fairer and simplifier system. By 2002, 35 states had enacted this legislation, sending delegations composed of legislators, tax administrators, local government officials and representatives of the private sector to monthly meetings that resulted in the formulation and approval of the Streamlined Sales and Use Tax Agreement. As of today, all of the sales tax states, except for Colorado, are participating in the ongoing process to simplify sales tax collections.

The key features of the Agreement are SIMPLIFICATION of sales and use tax laws and administration; the USE OF TECHNOLOGY for calculating, collecting, reporting and/or remitting the tax; and, STATE ASSUMPTION OF THE COSTS of collection for remote sellers. The key simplifications contained in the Agreement as adopted by the states are:

- Uniform product definitions, from food and related items to digital products
- Uniform state and local tax base
- Reductions in the number of tax rates
- Requirements for state/central administration
- Central seller registration
- Uniform returns and remittances
- Simplified exemption administration

- Uniform audit procedures / reduction of the number of audits
- Uniform privacy protections
- Notice requirements for rate changes
- Uniform sourcing
- Uniform telecommunications sourcing
- Uniform administrative definitions
- Eliminations of caps and thresholds on rates
- Standardization for sales tax holidays
- Uniform rounding rule

Since the Agreement was ratified in November 2002, 22 states have enacted legislation to bring their sales tax statutes and administrative rulings into compliance with the Agreement. On October 1, 2005, thirteen states with a population of over 55 million residents were certified to be fully in compliance with the Agreement. It is expected that on January 1, 2008 the states of Arkansas, Nevada, Washington and Wyoming will be in full compliance with the Agreement as their statutes become effective.

Table 2.

Member States	
Indiana	**North Carolina**
Iowa	**North Dakota**
Kansas	**Oklahoma**
Kentucky	**Rhode Island**
Michigan	**South Dakota**
Minnesota	**Vermont**
Nebraska	**West Virginia**
New Jersey	
Associate Member States	
Arkansas	**Utah**
Nevada	**Washington**
Ohio	**Wyoming**
Tennessee	

Sales Tax Fairness and Simplification Act

The Streamlined Sales and Use Tax Agreement is voluntary for states as well as for remote sellers. Since October 1, 2005, over 1,100 retailers have **VOLUNTEERED** to begin collecting sales taxes for the member states, and these states have started to receive previously uncollected revenues for sales tax on transactions made through out-of-state retailers.

I believe that you will agree that this effort to streamline sales tax collection has been unprecedented in our history. In less than six years, the states working together with the support and assistance of the private sector, developed a new sales tax system that was fairer, simpler, more uniform and is technologically applicable; 22 states, almost half of all the states with a sales tax, enacted legislation to comply with these changes; and, the system is working. It is operational! However, our work to establish a truly seamless system is only half done. It is now Congress' turn to act. The states through the Streamlined Sales and Use Tax Agreement have provided Congress with the justification to allow states that have complied with the Agreement to require remote sellers to collect those sales' taxes as was intended in the *Quill* decision.

The Sales Tax Fairness and Simplification Act, H.R. 3396, as introduced by Congressmen Delahunt, LaHood, et al, embodies all the simplification requirements of the Streamlined Sales and Use Tax Agreement and provides certainty for taxpayers, retailers and other businesses that the states cannot backtrack on simplifications but if we do, the prohibition of the *Quill* decision will be reinstated.

NCSL supports H.R. 3396 because the legislation:

- provides for a national small business exception so that sellers with less than $5 million in taxable remote sales would be exempt from collection requirements;
- ensures reasonable and adequate compensation for all sellers for the cost of collection;

- provides certainty to taxpayers and sellers by allowing for an appeals process that includes review of the decisions of the Governing Board of the Streamlined Sales Tax System by the United States Court of Federal Claims;
- ensures that any filings by sellers in the course of registering, calculating, collecting and/or remitting sales and use taxes collected cannot be used as a criterion for determining nexus for any other tax responsibilities, including state business activity taxes; and
- ensures that the Agreement simplifications are applied to the administration and collection of transactional taxes on telecommunications services.

Telecommunications Tax Reform

With regard to the last item above, you may recall that I appeared before this Subcommittee last year, invited by the former Chairman, Representative Chris Cannon, to discuss reform of state and local taxation of communications services. I had the pleasure to discuss how Congress and the states can work together to reform the monopoly era taxation scheme on telecommunications and I would like to reiterate what I said during my testimony in June of 2006.

The Sales Tax Fairness and Simplification Act would require states to apply the uniformity and simplifications of the Streamlined Sales and Use Tax Agreement to the collection and administration of all transactional taxes on telecommunications services, including rights of way fees and franchise fees, as a condition that a state would have to meet before the state could enjoy the authority to require remote sale tax collection.

Congress has the opportunity to move a major part of the telecommunications tax reform agenda, collection and administration simplification, and in doing so, reducing the number of returns from the current 47,000 to a few hundred a year. This would substantially reduce provider compliance costs by the hundreds of millions of dollars each year and as a result reduce the cost of service to consumers. <u>For this reason, most of</u>

the major telecommunications providers have endorsed the Sales Tax Fairness and Simplification Act.

One of the issues hindering telecommunications tax reform in the states is the potential loss of revenue primarily at the local government level. A recent study has shown that revenue from telecommunications taxes is becoming the second largest revenue source for local governments after the property tax. If state legislatures try to reduce telecommunications taxes to the level of general business tax, we have two options: reduce rates on telecom providers by reducing revenues over the opposition of local government officials or reduce rates on telecom providers and raise rates on general business to offset the revenue loss. As you can guess, every industry that is not a telecommunications provider will rise up to oppose this alternative.

States do not have large surpluses of funds available to mitigate revenue loss from telecommunications tax reform, even over the short term. However, states could use some of the new revenues from presently uncollected sales taxes on remote transactions to help mitigate revenue loss from telecommunications tax reform. Congress in passing the Sales Tax Fairness and Simplification Act could give states the revenue they would need to mitigate revenue loss from reducing the discriminatory rates on telecommunications services.

On behalf of state legislators across the country, I would urge the Congress to adopt this legislation and send it to the President for his signature. You have the opportunity to not only ensure the future vitality of our states' major consumption tax, but you also will establish a level playing field for all retailers and help to provide $6.8 billion a year in relief to American retailers. Instead of spending this money to collect state and local sales taxes, these business can re-invest these funds into our states' and nation's economy. You can help your state and local government as well as your retailers without having to appropriate one single cent from the Treasury or finding an offset.

Misconceptions and Misstatements

Over the last six years, as we have worked to develop a simplified and fairer sales tax system, we have heard criticisms and arguments against streamlining and against Congress setting aside the *Bellas Hess* and *Quill* decisions. I would like to take a few moments to correct some of the misconceptions that our opponents have made, some of which I am sure will be expressed this morning.

Myth: *"The Streamlined Sales Tax Agreement does not simplify tax compliance for retailers."*

Fact: Even if states did nothing more than adopt the proposed administrative changes contained in the Streamlined Sales and Use Tax Agreement, all retailers will benefit from reduced complexity. Opponents contend that rates are the biggest complication, but even Robert Comfort, Vice President for Tax Policy at Amazon.com, told a congressional hearing in 2001, "…rates are not a problem for Amazon.com." Sellers have testified over and over that the real burdens with collection are not sales tax rates but the different product definitions from state to state, different state and local tax bases and the different rules and administrative procedures for registering, collecting, filing and remittance of sales taxes.

Under the Agreement, the certified automated system calculates the sales tax to be collected not the merchant, based upon the delivery address submitted by the consumer. All merchants that collect sales taxes using the state certified automated technology would be held harmless for any miscalculations. The state assumes the liability from the merchant, who under the current collection system bears total liability. The merchant would only be held liable for under-collection, if the merchant tampered with the certified technology or fraudulently failed to remit the sales taxes collected.

Myth: *"The Agreement will pose a threat to consumer privacy."*

Fact: The Streamlined Sales and Use Tax Agreement has strong provisions that will protect the privacy of all consumers. The Agreement provides that a certified service provider "shall perform its tax calculation, remittance, and reporting functions without retaining the personally identifiable information of consumers." The only time that a certified service provider is allowed to retain personally identifiable information is if the buyer claims an exemption from taxation.

The Agreement requires the certified service providers to retain less information than is currently captured by VISA, MasterCard, American Express, Discover, or any other credit card company when a consumer makes a purchase and these companies can use this information for marketing purposes. If certified providers use or sell any information gathered from calculating sales taxes, they would lose certification to be a collector.

Let me set the record straight; the only information maintained by the vendor or third party collector for sales tax calculation are product, price, zip code, and sales tax collected. Unless the consumer is the only person living in the zip code, no one would know who the consumer is!

Myth: *"The Agreement will force states to forfeit sovereignty over tax policy to out-of-state bureaucrats."*

Fact: No, the Streamlined Sales and Use Tax Agreement does not force any state to forfeit its sovereignty. Compliance to the Agreement is always optional for a state. The decision to comply with the Agreement can only be made by the state legislature and governor—and they can withdraw at any time.

Each state that complies with the Agreement will have one vote on the Governing Board of the Agreement. Each state that complies with the Agreement can have a delegation of up to four people with the state legislature in each state deciding who represents the state. In many cases, state legislators and tax administrators have been designated to serve on the Governing Board. The Agreement protects the sovereignty of each state to decide who represents them.

The Agreement also requires a 60-day notice on amendments that must be sent to the governor and the legislative leaders of each member state; the same governor and legislative leaders who have appointed the delegates to the Governing Board. The Streamlined Sales Tax Governing Board cannot change any state's sales tax statute, only the state legislature and the governor have that authority and nothing in the Agreement abrogates that authority.

Myth: *"The Agreement and federal legislation to require remote sales tax collection would violate the Constitutional doctrine of federalism. It would force businesses in states where the legislatures have chosen not to join the system or do not have a sales tax to collect sales taxes for other states."*

Fact: The Streamlined Sales and Use Tax Agreement does not in anyway violate the Constitution and is actually a vibrant example of federalism. The Agreement is voluntary for states and for merchants, this is not a mandatory compact or violation of the Commerce Clause of the Constitution. The states voluntarily participated in the process to formulate the Streamlined Sales and Use Tax Agreement by enacting legislation by the people's elected representatives in each state, signed by the governor. The Agreement ratified by the states' delegates, responds to the challenges raised by the Supreme Court in two decisions, *Belles Hess* and *Quill*, and provides a blueprint for Congress to overturn these decision.

Should Congress grant states remote sales tax collection authority if they comply with the Agreement, then businesses that are located in a state that chooses not to comply with the Agreement or that has no sales, tax would only be subject to collection requirements under the Agreement if that seller chooses to sell into a state in which the legislature has decided to comply with the Agreement. Opponents exclaim fear that *"This implicates profound practical and theoretical federalism concerns."* However, no seller is forced to sell into states that comply with the Agreement. Out-of-state sellers make that decision and in doing so, they also make themselves liable to the other state's non-sales taxes statutes and regulations protecting consumers and conducting business. An insurance company domiciled in Illinois must follow New Hampshire's insurance laws when doing business in New Hampshire, the same for banks and many other interstate businesses.

Myth: *"The Agreement will reduce tax policy competition between the states."*

Fact: No. As I have stated many times, the state legislature in each state that complies with the Streamlined Sales and Use Tax Agreement will still decide what is taxed, who is exempt and at what rate it wants to tax transactions. How is tax competition eliminated by simplified administrative efficiency or even uniform product definitions? In fact, the competitive strength of America's businesses would be enhanced by reducing the regulatory complexity, costs and burden of the current state sales tax collection system on businesses. <u>Who could oppose reducing or eliminating the current $ 6.8 billion a year it costs American retailers to collect our sales taxes?</u>

The Streamlined Sales and Use Tax Agreement is a prime example that states are "laboratories of democracy." States working together have developed a solution to ensure the viability of a major revenue stream while eliminating the burden, complexity and cost on retailers to collect the states' sales taxes and maintaining state sovereignty for tax policy. State legislators and governors are finding ways to maintain vital government services such as education, health care, public safety and homeland security while ensuring the viability of America's businesses in a global marketplace.

Myth: *"The Agreement will impede the success of electronic commerce. Collecting sales taxes on electronic commerce transactions is a new tax."*

Fact: Under the Streamlined Sales and Use Tax Agreement, the buyer making a transaction will not need to fill out any additional forms in order for the sales tax to be calculated or collected. The tax is determined by the delivery address, and anyone who is buying a tangible product online wants to make sure that the product is delivered to the right address. The consumer fills out only one address field. In cases of digital products like online books or movies, the online seller wants to be paid and they will not accept a credit card payment without address verification. Once again, no additional tax form would be required.

A study released by Jupiter Research in January 2003, *"Sales Tax Avoidance Is Imperative to Few Online Retailers and Ultimately Futile for All,"* found most people are unaware that they are not paying sales taxes when they make a purchase over the Internet. In the same study by Jupiter, only 4 percent of online buyers said that the collection of sales and use taxes would always affect their decision to buy online.

The effort to streamline sales tax collection is not a new tax on electronic commerce. Online sellers already collect sales taxes where they have nexus. The effort of states to streamline sales tax collection will only remove the burden from all sellers in collecting a tax already levied by state and local governments.

Myth: *"The University of Tennessee's study on revenue loss for states due to remote sale transactions is not accurate. The estimates of revenue loss are too high."*

Fact: The Business and Research Center at the University of Tennessee issued its first study on potential revenue loss due to transactions that occur through remote sellers, including electronic commerce in 2001. This study was updated in July 2004 at the request of the National Conference of State Legislatures and the National Governors Association. The updated study shows that the estimates of potential revenue loss was not as high as first predicted. The authors of both studies, Dr. Donald Bruce and Dr. William Fox, provided the following explanation for the difference in estimates between 2001 and 2004: " The experience of the last several years indicates that e-commerce has been a less robust channel for transacting goods and services than was anticipated when we prepared the earlier estimates. The findings provided here are based on lower estimates of e-commerce, and the result is a smaller revenue loss than we previously indicated. Our loss estimates are also lower because many more vendors have begun to collect sales and use taxes on their remote sales. Still, the Census Bureau reports a combined $1.6 trillion in 2002 in e-commerce transactions by manufacturers, wholesalers, service providers, and retailers, and Forrester Research, Inc.'s expectations continue to be for a strong growth in e-commerce in coming years. Thus the revenue erosion continues to represent a significant loss to state and local government."

Myth: *"The Agreement will widen the digital-divide, because it will disproportionately impact rural, low income, disabled or even elderly buyers."*

Fact: If brick and mortar stores are not as accessible in rural areas as they were say, ten years ago, perhaps they no longer can afford to compete with the price advantage enjoyed by online/remote sellers that do not collect sales taxes. When brick and mortar stores in rural areas are forced out of business that means the rural farmer will have to pay higher property taxes on his farm or increased state income taxes. Higher property or income taxes, just so that one can buy a book or CD on-line sales tax free?

Opponents imply that the streamlined sales tax effort will "*have the effect of widening the so-called "digital divide."* Unfortunately, they fail to show an equal concern for those hard working Americans who may lack the credit or the ability to shop on-line because of a lack of access to the Internet or even a computer. These Americans are paying the sales tax every time they make a purchase in a local brick and mortar store. However, those consumers who have sufficient credit, home computers and access to the Internet are able to avoid the sales tax with almost every online purchase. In truth, if the states fail to simply their sales tax systems and Congress fails to give states that comply with the Agreement remote sales tax collection authority, the consequences will be the greatest for low income Americans who do not have the resources to shop out of state.

Myth: *"The Agreement is a good concept but it can never really work."*

Fact: Since the Streamlined Sales Tax System became operational on October 1, 2005, over 1,100 remote sellers have volunteered to begin collecting sales taxes for those states that have complied with the Agreement. The certified service providers were approved in

May of 2006 and even before the certified automated system was online and available to sellers, these sellers had started to collect sales tax and remit those taxes to the states. The Streamlined Sales Tax System is so much simpler that without even the software in place, remote sellers could begin collecting sales taxes on transactions made by residents of these states.

Conclusion

In closing, I would like to reiterate for the members of this Subcommittee that twenty-two states have enacted compliance legislation and many others have enacted some of the changes needed to comply with the Agreement. I believe we are at a point that if Congress fails to act soon on the federal legislation as envisioned in the Sales Tax Fairness and Simplification Act, the momentum in the remaining states will slow. In some of these states, compliance to the Agreement may require politically difficult changes to the sales tax statutes. Congressional approval of this legislation will help the legislatures in those states make the necessary changes. As I stated previously, states have made unprecedented progress to eliminate the burdens and costs to retailers that the *Quill* decision outlined. It is now Congress' opportunity to ensure that the simplified system that the states have developed for the seamless collection of transactional taxes in the new economy is not impeded by those who merely are trying to avoid paying legally imposed taxes.

Thank you.

Ms. SÁNCHEZ. Great. Thank you, Mr. Rauschenberger.

We will now begin our round of questioning. And I will begin by recognizing myself for 5 minutes.

My first question is for Ms. Wagnon. In establishing a uniform set of rules, one of the heated discussions that a uniform rule—for a uniform rule is the issue of sourcing for sales taxes and whether the taxing should be based on the destination of the goods or the origin of the goods. As the secretary for revenue of Kansas and knowing that Kansas has altered its sales tax system, what insight can you provide about the change from destination to origin sourcing?

Ms. WAGNON. It was painful. I think the concept of using destination sourcing makes sense. But it does require an adaptation on the part of, in Kansas, about 25 percent of our retailers. And we had to provide the rates and boundaries database. We had to provide consistent assistance. And I am still sending some of our technical staff from revenue out to companies that deal in many jurisdictions. We have 750 jurisdictions.

We made the conversion because all of us believe from the governor to the Republican and Democratic leadership that this was an appropriate thing to do. But the political reality is that there are 10 States or more that some of which are associate member States now that have tried and simply cannot get that done. The state of Texas is very interested in being part of this.

They were involved from the very beginning. But they don't see this as politically possible. So we are now considering on the governing board next week an option to allow for origin sourcing instate and uniform among any State that would adopt that. So it would be an addition to our sourcing rule.

It would still be uniform so you won't have all origin States doing everything differently, but one rule. And then for the remote sales, either destination sourced. Or the other proposal that is being considered is a single rate. And we will be debating that and making a decision. I think the political reality is it simply is not going to accommodate all the States that need to be there with the rule that we have in place.

The state of Washington has its deadline for making its conversion on July 1 of 2008. Arkansas has made a conversion. Iowa made some changes. But Ohio has been unable to do it. Utah has been unable to do it. Tennessee has been unable to do it.

And we are trying to adjust so that we can bring in these other groups. I hope that is sufficient.

Ms. SÁNCHEZ. Thank you.

Mr. Zakrzewski, some opponents of the SSUTA and the legislation Mr. Delahunt has introduced argue that the collection and remittance of sales tax by remote sellers would impede electronic commerce. And I know that you are a representative of a company that conducts business online. So in your experience, would the requirement of collecting and remitting sales tax impede electronic commerce?

Mr. ZAKRZEWSKI. It shouldn't impede electronic commerce. Today you have to have a system that takes your order and records it and tells the customers what the price is.

With the streamlined sales tax project, the project provides software and certified service providers that will come in and attach to your system and collect the tax and tell your customers how much that tax is. So to me it is really not a legitimate concern that that would impede commerce because not only can you do it, you are doing it at least in the State where you are located today and software to do it for a multi-state is free.

Ms. SÁNCHEZ. So with the emerging technology you have found a solution to that particular problem?

Mr. ZAKRZEWSKI. That provides a solution to these sellers.

Ms. SÁNCHEZ. Thank you.

Mr. Isaacson, is there any policy reasons why the medium to which a particular good is sold to the consumer should dictate whether it is subject to sales tax? The question specifically is is there anything about the Internet that suggests sales of goods ordered over that medium should not be taxed?

Mr. ISAACSON. The issue is not whether goods should be taxed if they are sold over the Internet or not. As I pointed out before, multi-channel merchants who are selling over the Internet such as JCPenney are collecting. And a large number of the largest companies are, in fact, doing so. So that is not the issue.

The issue is whether a company that has no presence within a State does not benefit in any way from any services being provided by that State, does not get tax increment financing for building new facilities or getting bypasses and access roads built to its stores, who has no political role in that State whose employees are not voting in that State, whether it is appropriate for a 7,600 tax jurisdictions to be able to export their unique and non-unifying tax systems across their State borders to 49 other States. That is the issue the Supreme Court has repeatedly addressed and has said that the commerce clause protects commerce from that type of approach.

It also happens to be the reason the commerce clause was adopted in the first place. What was happening in 1878 and the reason why the convention was called in Philadelphia was because States were imposing tariffs, duties and taxes on each other's trade and the country was going into a depression. And the commerce clause is what created the unified market to prevent them.

Ms. SÁNCHEZ. Thank you. I see my time has expired.

So I will recognize Mr. Cannon for 5 minutes.

Mr. CANNON. Madam Chair, would you mind if I deferred my time?

Ms. SÁNCHEZ. Not at all.

We may do a second round, depending on the interest of questions.

Mr. CANNON. I shall do everything in my power to help us get done in one round.

Ms. SÁNCHEZ. Okay, Mr. Delahunt, you are recognized for 5 minutes.

Mr. DELAHUNT. Thank you, Madam Chair. I was going to direct my question to the three panelists other than Mr. Isaacson. Mr. Isaacson made the statement that this was a government exercise. The implication being that we are a bunch of bureaucrats stuck in a corner someplace. At least this is the way I interpret. And maybe I am mischaracterizing.

But would you explain to me—maybe there was some packet of missions that weren't allowed in or maybe even a professor of constitutional law at a fine institution, a fine ivy college up in Maine didn't participate. But the point is I think it was misleading because—and why don't I address it to Secretary Wagnon.

How did this come about?

Ms. WAGNON. Well, I think——

Mr. DELAHUNT. What was the process? I know you have had numerous amendments. And I congratulate you, by the way, on having numerous amendments. I think what that reflects, at least from my vantage point, is an effort to get it right and to do it well and to attempt to look at a very complex problem and to achieve a balanced resolution.

Ms. WAGNON. And I think that is exactly correct. It started out with governors, State legislators, and business representatives as well as tax administrators. The members of the governing board are selected by the State. Some of them are business representatives.

Mr. DELAHUNT. If I may, Madam Secretary. The National Governors Association, I know, in the past has taken a position on earlier versions of the bill that is before us. Are you aware of their position on this particular legislation?

Ms. WAGNON. Yes, I am. We work very closely with NGA, NCSL, the Federation of Tax Administrators, all of the organizations that they support.

Mr. DELAHUNT. What is their position on this bill?

Ms. WAGNON. They are supportive of this.

Mr. DELAHUNT. Do you know how many of the governors have indicated their support for this particular or earlier versions of this legislation?

Ms. WAGNON. It is a little difficult for me to answer that because governors keep going in and out of office.

Mr. DELAHUNT. I know. They keep coming and going.

Ms. WAGNON. And Governor Leavitt was a good example of a leader early on who is now no longer in that position. But the fact that 22 States have embraced this legislation and governors have signed it—there is a minimum of 22 and probably 10 more that were involved earlier. The NGA has consistently had a position on this legislation in support of it. And that is true also for the National Conference of State Legislatures.

Mr. DELAHUNT. Let me go to Mr. Rauschenberger and ask him to respond to both of those questions.

Mr. RAUSCHENBERGER. I am happy to have the opportunity because I don't think it is the only thing Mr. Isaacson got wrong. I have been involved since——

Mr. DELAHUNT. Well, don't——

Mr. RAUSCHENBERGER. You know State legislators. You shouldn't let us near microphones anyway. Since 1999 I had been a co-chair of a task force that NCSL has had to work on this issue. I have never participated in a meeting that wasn't a public meeting. We spend more time with members of the business community. It is why we have so much broad-based business support.

There is only a single association I am aware of that they looked hard to find that was in opposition. So to say that this was done by bureaucrats—this was done by elected officials and people representing the business community together with people who understood the tax system, which makes sense to me.

To the question of support, NCSL has supported this effort since 1999, which requires a majority, I think 70 percent, of the 50 States to be in support at all times for us to have stayed in continuous support of this. We have had a lot to do with drafting it.

And I think the number I recall is—I think it was Franklin who presented more than 50 changes to the Constitution before it was finally ratified. The amendment process is about seeking perfection, not about confusion about goals.

Mr. DELAHUNT. And let me just make a comment, too. I think you said something here that is very significant. We do have a unique system of federalism. And I think it is very important for this Congress to respect federalism.

I happen to embrace the concept of devolution and States' rights. Sometimes I am surprised at my colleagues of your party that seem to believe that Washington knows best in terms of what the States ought to do or ought not to do.

But out of respect for the States I think it is important that we understand that this is about sustaining that system of federalism and conferring to the States the power to raise revenue which is justifiably there. I want to commend you all for really a tremendous effort and for the significant progress that you have achieved. I wish we could do the same here in the United States Congress.

And with that, I will yield back.

Ms. SÁNCHEZ. The gentleman yields back.

Mr. Cohen is recognized for 5 minutes of questions.

Mr. COHEN. Thank you, Madam Chair.

First, I would like to say hello to my former colleague and good friend, Mr. Rauschenberger.

It is good to see you.

Mr. RAUSCHENBERGER. Good to see you. You look taller and better now.

Mr. COHEN. It is Congress. We have a great basketball team.

Tennessee is a State that is heavily sales tax reliant and yet has been somewhat reticent, maybe, to become a full-fledged member. And I probably should know the answer to this. But can you tell me why Tennessee, a State so starved for revenue, is an associate member and hasn't joined in?

Mr. RAUSCHENBERGER. The sourcing complications of the local jurisdictions have been a hard bite for both chambers in Tennessee to embrace. Most of the States that are having trouble coming into compliance it is around the changes required and the risks that are assumed by the local jurisdictions in the sourcing change and its effect on local revenues. States that have kind of bridged that gap have done it.

And I think Washington is one of them which actually set aside, directed the set-aside of a major portion of the new increment revenue and used that as a hold harmless to kind of solve the local jurisdictional problems. But that is my best understanding right now.

Mr. COHEN. And I have thought about this issue. And, of course, Mr. Isaacson, I read your statement. There is a lot of revenue that—your brief or the brief that is attached to it questions how much revenue the Tennessee study suggested we might be losing in Tennessee. But there is considerable revenue, and there is the years to come of revenue. When you have a State like Tennessee and there are only a handful that don't have an income tax and that are relying on the sales tax. It really does deprive people of basic services because you have got a progressive tax system.

And if you have a State, Mr. Isaacson, with a progressive tax system like Tennessee has and others without any major source like oil or gambling, Nevada, Texas, and those other States that don't have any income tax, how would you suggest that they survive in the future years to provide the services to people that need education and health care and help with the utility bills? Should they just kind of let e-commerce grow and grow and grow and their sales base just decline?

Mr. ISAACSON. It is a fair question. And I think that there is a clear answer to your question. I think the starting point has to be understanding what are the numbers that we are dealing with.

If you look at the United States Commerce Department figures in regard to those States that are currently full members and based on that commerce department data, the lost tax revenue is $145 million. So dealing with what is the scale of the issue, I think, is significant.

One of the reasons why Tennessee has not wanted to participate in this process is that Tennessee has had different tax rates or different kinds of products, agricultural products, heavy equipment, for example, different tax rates, and not wanting to conform to the tax regime or protocol that the SSUAT has called for. That is part of their sovereignty. That makes sense.

The real reality is that this problem is largely self-correcting because companies do start collecting as they expand their businesses. The incubator is electronic commerce. The long-term business plan is to leverage grand equity, establish retail stores, provide after-sale customer services and by doing so, establish a nexus. That is what we are seeing in all of the major large retailers. And I think it is a development that says that we don't need to be concerned about the future in the manner that has been described by my co-panelists.

Mr. COHEN. I hope you are right. We have been waiting for Saks to come to Memphis for a long time.

Mr. Rauschenberger says that they searched long and hard to find you. Are there other business groups that are against this proposal that you are familiar with?

Mr. ISAACSON. I don't know what he means by long and hard. When the project began in 2000, the Direct Marketing Association submitted 30 suggested reform proposals. And I met with the leaders of the organization at that time.

Of 30 proposals that were recommended by the Direct Marketing Association, only one was adopted.

Mr. COHEN. I don't think that—other than the Direct Marketing Association, other business or commercial groups that are in opposition to this. He said that you were kind of a singular——

Mr. ISAACSON. There are. And I don't speak for them. Some of them are in the room today.

Mr. COHEN. They are in the room?

Mr. ISAACSON. I believe so. I have been talking to them. I haven't looked behind me while I have been questioned, but they were here earlier today.

Mr. COHEN. Some of them are nodding their heads. We will figure out who they are later.

I appreciate you on that. And I really appreciate the work of the NCSL. It is well-represented here. And there are two of your predecessors, I guess, were Claybough and—Bill Claybough and Matt Kisworth. They were great State legislators——

Ms. SÁNCHEZ. The gentleman yields back?

Mr. COHEN. I do.

Ms. SÁNCHEZ. The gentleman yields back his time. There is sufficient interest on the part of Members of the Committee and a second round of questions.

Mr. CANNON. I think actually this is still the first round. But, I mean, I understand there is a second round.

Ms. SÁNCHEZ. I apologize. You are correct, Mr. Cannon. You are recognized for 5 minutes.

Mr. CANNON. Thank you, Madam Chair.

I appreciate you all being here.

We appreciate, Ms. Wagnon, the update. I think that is the only new thing that is on the table today. And that is appreciated.

And, Mr. Isaacson, you know, you said it all very well. And then frankly now, Mr. Rauschenberger and I probably need to go back and punt a little bit because we have had this same discussion many, many, many times. And to suggest that there is error in your thinking, I think, is appropriate. Personally we have looked at all the data, I think, and we have not seen errors in your presentation. That was very concise. I think this is probably the fourth time you have made a presentation like this to this Committee. And that was by far the most elegant, not new particularly, but well-done.

Let me see if we can get some basic consensus on issues here. And I do this in the context of many other hearings. But do we have a basic consensus among the panelists, for instance, that the Internet is one of the major drivers for economic growth in America?

Ms. Wagnon?

Ms. WAGNON. I would agree with that.

Mr. CANNON. Well, we have unanimous view on that, which is good because that means we are all in America, we are all recognizing what is going on.

Is there unanimity on the idea that there is a tendency for ideas on the Internet—remember, we have these hierarchies. You have got business-to-business as far as you getting taxes paid. And I think Mr. Isaacson laid those out. And I don't think there is much disagreement with that.

But in the environment where you are getting new ideas on the Internet, is there any disagreement by anybody on the panel that the tendency of those new ideas as they succeed is to become multi-channel, which means they tend to become not just clicks, but clicks and bricks?

Ms. Wagnon?

Ms. WAGNON. I think there are going to continue to be a rise in the number of pure Internet retailers. The figures that I saw in the New York Times last week——

Mr. CANNON. Pardon me. I agree with you on that. But the question is as you get this increase in retailers, is there a tendency for those to—as they become successful, is there a tendency to move into bricks so that you have nexus.

Ms. WAGNON. And I would not agree with that. I think we have seen a number who have registered that are in that situation where they are multi-channel clicks and bricks. But there are many out there that are going to never adopt that model. So I would dispute that.

Mr. CANNON. Can you tell me what is it about those that means they won't adopt the model?

Ms. WAGNON. They don't want a brick and mortar store. They like to remain pure Internet sellers.

Mr. CANNON. But if they succeed and they brand themselves, won't they tend to want to become multi-channel?

Ms. WAGNON. I don't think you can State that universally, no, sir.

Mr. CANNON. No, no, no, this is not universal. I am suggesting there is a tendency. I think I used the word trend or tendency for successful stores to go multi-channel.

Ms. WAGNON. I think the trend is that the stores that are successful—the most recent one that was announced in the paper was like Cabella's, which have separated everything. They are going to multi-channeling so that you can return the goods in the stores.

Mr. CANNON. Right.

Ms. WAGNON. So if you have a store there, the tendency is to adopt that. But you also have to understand that that is not going to solve your tax problem if you haven't broken in yet.

Mr. CANNON. Okay. But we are just looking for broad consensus on trends here. And Cabella's, of course, is a great example because the fact is—and I think Wal-Mart was probably the first that tried to have separate channels and then went back to a merging because people want to return their items to a store. It is easier to return to a store than it is to put it back in a box.

But that would argue for the underlying trend. Now, you may have boutique operations forever, but an operation that has less than $5 million in revenue is exempted, so you don't care about those little guys.

Ms. WAGNON. Well, Amazon doesn't have a store that I am aware of.

Mr. CANNON. Amazon is one of the uniques, I grant you that.

Ms. WAGNON. And they are huge. So I think there are two trends, sir. That is my point.

Mr. CANNON. No, no, the point is not that all stores will become multi-channel. And clearly, Amazon is one of those very interesting cases where they are struggling and trying to figure out where they are going. They are competing with companies that have advantages because they have clicks and bricks.

And so, Barnes and Noble is where somebody can go and drink coffee and read a book and then decide to buy it. Barnes and Noble is a place where you can just stop on your way to work and pick up a book if there is something you wanted to read. So there are advantages to both places.

Mr. Zakrzewski?

Ms. SÁNCHEZ. Zakrzewski.

Mr. ZAKRZEWSKI. Zakrzewski.

Mr. CANNON. Do you pronounce the second z?

Mr. ZAKRZEWSKI. Zakrzewski.

Mr. CANNON. Zakrzewski, okay. Mr. Zakrzewski, do you agree that there is a broad trend to go multi-channel and therefore, if you are successful on the Internet to create bricks as well as clicks?

Mr. ZAKRZEWSKI. What you have described is stores like Barnes and Noble, stores like L.L. Bean, Eddie Bauer and stores that began as bricks going to clicks. I am trying to sit here and think of an example of a pure Internet retailer, though, that——

Mr. CANNON. Well, actually, Eddie Bauer was a catalogue that went to Internet and then went to bricks, I think, after they went to the Internet.

Mr. ZAKRZEWSKI. They had a store——

Mr. CANNON. Okay, I can see we don't have broad consensus on this.

Mr. ZAKRZEWSKI. I don't think you do.

Mr. CANNON. So let me just say that it is my view of the world that success in American markets—this debate could go on eternally. I see that my time is expired.

I will reserve the right to participate in the second round if new issues would arise, Madam Chair. And I yield back.

Ms. SÁNCHEZ. I thank you, Mr. Cannon, for being so cognizant of your time.

Mr. CANNON. The Chair could have poked the Ranking Member and I would have recognized sooner that my time had expired.

Ms. SÁNCHEZ. You were just over the 5-minute mark. We are not going to hold it against you.

There is sufficient interest in a second round of questions.

And I will recognize Mr. Delahunt.

Mr. DELAHUNT. Yes, I would like to follow up on the respect that was implied in a question by my friend from Utah, Mr. Cannon. And we are talking about Eddie Bauer. We are talking about L.L. Bean. You know, I have a concern.

The small, independent business that I think adds something to the community—I am not saying that Eddie Bauer does not. I am not saying that Barnes and Noble doesn't. But there is something more than just the economic factor in this particular equation.

As I said in my opening remarks, I think this is, you know, Norman Rockwell home town small business protection act. I really do. If we are going to have a space for the continued existence of that kind of entity that, I think, is a significant piece of what we know in terms of the American experience, how are they going to compete when they are put at a competitive disadvantage ranging from 3, 4, 5, 6, I think it is 8 percent in Florida?

Mr. Rauschenberger?

Mr. RAUSCHENBERGER. I think your point is well taken. This bill, your bill levels the playing field and makes the amazon.coms of the world play by the same set of rules that the open hearth bookstore in a little town plays by. What is more, it also for the first time obligates States to pay reasonable reimbursement, reasonable compensation to businesses for collecting their sales taxes.

I mean, those are two important strides forward. You know, we don't know what the products that are going to be in the marketplace 3 years from now, let alone 30 years from now. So this is exactly the right thing to do.

Mr. DELAHUNT. I mean, one only has to look at the economy in terms of mergers, acquisitions, consolidations, et cetera. I think we lose something as a society when, you know, I can't go into the local drug store anymore like I did when I was a child and go to the soda fountain and sit down and communicate with Mr. Johnson and have him ask about, you know, how is mom and dad. That is not happening today in this country. And I think we miss something as a result of it.

You know, Mr. Isaacson spoke about, you know, core constitutional—or erosion, if you will, of core constitutional safeguards.

I mean, Secretary Wagnon, I read the *Quill* decision. And it said to me, "Congress, do something about it." Can you explain to me—do you have an understanding of the constitutional erosion of core values?

Ms. WAGNON. I think the Supreme Court was very clear in the *Quill* decision saying that when simplification and the burden is removed, Congress can require that. In fact, the Supreme Court threw this back in your lap. And I think we have come to you today to say we have achieved those simplifications. We can certainly achieve more.

But we have a functioning board. We have a functioning process. We have gone a long way. And it is time to recognize that you make a burden across all businesses equal, large to small. So, yes, you are right.

Mr. DELAHUNT. Again, Secretary Wagnon and any panelist, I mean, I keep hearing about how complicated it is. Seventy-five hundred taxing jurisdictions. You know, to be perfectly candid, I think that is fooforall.

I mean, I am hearing from—what you are saying is one simple form, one simple reporting form. I mean, don't give me that when somehow you have done it and people are voluntarily complying.

Mr. RAUSCHENBERGER. But every one of those sellers uniquely has a zip code, which is the source of the taxing. The States have agreed to match every zip code to a tax rate. So the question of one rate or complications or allowing States to sovereignly decide to allow governments, municipalities to impose sales taxes is over. It is no more complicating than saying do you realize Members of Congress vary by height by more than seven inches.

Mr. DELAHUNT. But at the same time—and you make a point—you are taking the burden or the cost of collection away from the remote seller. Am I accurate?

Ms. WAGNON. Yes.

Mr. DELAHUNT. I mean, I guess I am frustrated. I have been involved in this particular issue for 7 years. To me it just—well, I don't know.

Does anyone have an opinion on the small business exemption? Because this is a small business bill.

And, you know, Mr. Isaacson, I presume that Mr. Cannon is going to give you some time. But I don't know.

Ms. SÁNCHEZ. And, Mr. Delahunt, your time has expired. But I will allow the panelists to answer.

Mr. DELAHUNT. Well, thank you so much. The question is we do have the small business exemption, which would require businesses in excess of $5 million nationwide and gross taxable sales in excess of $100,000. Would you alter that? Would you tweak that?

You know, we are open. I mean, I am trying to protect small businesses in this country. I want them to continue to exist and be able to flourish and grow and to prosper. Can we help.

Secretary Wagnon?

Ms. WAGNON. I think the small business exemption is important to have. Whether it needs to be stated in the congressional act as to exactly what the limit is, it could perhaps be decided by the governing board. You could put that in section 6 of the bill and then let the governing board adjust that exemption as economic times change. But I believe you need to protect those small businesses. And there are several ways to get around it.

We have had proposals come before the governing board about what ought to be that deminimus rule. I believe the governing board is the best place to have that debated.

Mr. DELAHUNT. Thank you.

Thank you, Madam Chair.

Ms. SÁNCHEZ. Thank you. The gentleman's time has expired.

Mr. Cohen is recognized for 5 minutes.

Mr. COHEN. Thank you, Madam Chair. I am going to go back to Mr. Rauschenberger and ask him. This whole thing with origin and destination—that is a Tennessee issue, too. That hasn't been resolved, has it?

Mr. RAUSCHENBERGER. Unfortunately, it is the nexus, it is the point of most of the problems. If a State chooses to source the sale at the location of the seller, there is no way to avoid the seller moving his presence or his official office to a non-tax jurisdiction.

So every State that has a traditional or historical origin, you know, retailer-based sale origination is going to have to adjust that if you are going to solve the problem of remote sellers because sales taxes, unlike what some people may think, are not imposed on the seller. They are imposed on the purchaser and collected by the seller.

So States should have to go through some measure of political pain and reform. You can't have reform without change. But sourcing is going to be tough for all States. It is California's challenge. It is Illinois' challenge and part of Tennessee's challenge. But if you don't move the sourcing of the sale to the address of the buyer, you can't get at the fundamental inequities because the seller simply moves his Web site, his mailing address to the Cayman Islands.

Mr. COHEN. What my memo says is that Tennessee wants to have an origin rule or a portion origin rule. How would that differ from the destination?

Mr. RAUSCHENBERGER. Well, the streamline sales tax in one of those 170 or 140 amendments that they are considering, which are good because they are about—that is how we debate in the process—are considering what might be a bifurcated rule where the sourcing for sales that occur both from an in-state seller and an in-state buyer would be sourced on an origin basis but sales originating from outside of the State's jurisdiction would use a destination source or a bifurcated rule.

The fundamental problem of that are two things. Number one, there is a question of equal protection under the U.S. Constitution. Can you treat different sellers in a different way under your law? You know, there is a question there, which probably Secretary Wagnon probably is better expert at that than I am what our chances are there as well as there is some question of in States which have multiple rates, whether they will have to adopt a blended rate or one rate for all incoming sales.

Mr. COHEN. So are we talking about more of an intrastate sales issue?

Mr. RAUSCHENBERGER. Yes.

Mr. COHEN. I can see where Tennessee would have a problem with that.

Mr. RAUSCHENBERGER. And the solution is elegantly simple but really politically difficult. So it is normal. It is right that States are struggling with this. But——

Mr. COHEN. The other issue—apparently there are 19 simplification requirements in this bill. And my notes inform me that so far six have been met. Is that accurate? No? How many have been met?

Ms. WAGNON. All but one.

Mr. COHEN. All but one?

Ms. WAGNON. And the issues and resolution, dispute resolution is the only one we have not addressed.

Mr. COHEN. Okay, well, that is good. For a minute I was concerned you all weren't doing any better than the Shia and the Sunni. But that is good. Thank you.

Madam, I yield.

Ms. SÁNCHEZ. The gentleman yields back his time.

Mr. Cannon is recognized for 5 minutes.

Mr. CANNON. Thank you. Let me just make one point for the record. The political problem in a State for adjusting between the source of the sale and the destination of the sale is that often cities have created incentives for big box companies and instead of the sales receipts coming to the city that gave those incentives, they go to the city where the person came to buy. So rich cities end up buying more stuff from big boxes and getting more money. And the other cities end up tending toward bankruptcy, which is one of, I think, the fundamental problems.

I suspect, by the way, that the current governor of Utah, Governor Huntsman, opposes the SST. I am not sure he has been on record with that. But we certainly have moved in the other direction in Utah.

We have talked a lot about the leveling of the playing field. The fact is the playing field is level unless you disagree with me. And raise your hand or something if you do. The cost of delivery pretty much—wait a minute. Let me get the statement out, you know, the particular. Let us get the particular out so you can particularly disagree.

I know that there are some interests here. I am astonished at the idea that this would be called a small business bill when we have JCPenney's here and we have Staples pushing this and other companies around the country. People that want this done are people that are working hard to create a rigid system where they can continue to succeed.

But the cost of doing business on the Internet is greater because it is on the Internet. So you have a delivery cost, which is roughly equal to the cost of sales. That is not 5 minutes, was it, Madam Chair?

Ms. SÁNCHEZ. No.

Mr. CANNON. Is that not true that the cost of doing business is relatively equal because the cost of delivery is more or less the same as the cost of tax for an Internet company?

Mr. ZAKRZEWSKI. That is not necessarily true.

Mr. CANNON. Well, how far off true is it?

Mr. ZAKRZEWSKI. Well, I mean, it is going to depend on what the individual business model is. But you have still got to get delivered goods to the customer through a store or through——

Mr. CANNON. Well, that is right because the customer walks into the store. That is the point.

Mr. ZAKRZEWSKI. But you have got—there is still a delivery cost built into the cost of goods that you can sell in your store.

Mr. CANNON. Sure, but when you deliver a truckload of goods to a store that is not the same as delivering an item to a buyer across the country.

Mr. ZAKRZEWSKI. But it is not true that there is a pure additional incremental cost for that delivery charge.

Mr. CANNON. Wait, wait, wait. You are saying it is not true that there is—you are saying that there is not a clear delivery cost for an item that is sold online and shipped across the country?

Mr. ZAKRZEWSKI. No, I am saying that it is not true that there is a pure difference that is equal dollar for dollar to that delivery cost.

Mr. CANNON. But we are talking about more or less here. But we are not talking more or less. We are just talking about the cost of delivery. You would not disagree that there is a significant cost to deliver something that has been ordered on the Internet.

Mr. ZAKRZEWSKI. That is true.

Mr. CANNON. Well, thank heavens. We got some consensus here. Amazing.

Is there any disagreement that if we did an SST interstate compact that that would create the second biggest tax collection agency in the history of mankind, the Federal Government being the first, Steve? Yes. No?

Mr. RAUSCHENBERGER. It isn't comtemplated at all.

Mr. CANNON. Who is going to collect the taxes?

Ms. WAGNON. The States.

Mr. RAUSCHENBERGER. The 50 States, the same ones——

Mr. CANNON. No, no, no, the SST is going to collect and distribute the taxes.

Ms. WAGNON. No.

Mr. RAUSCHENBERGER. No.

Mr. CANNON. No. Explain to me how this works.

In fact, Mr. Isaacson, you have been very clear on these points. Would you mind explaining how it works? You think he would learn something in the process.

Mr. ISAACSON. What, you are going to have 7,600 different tax jurisdictions that are now going to be allowed to administer their tax systems in 49 other States. And so, you are, in fact, going to create one of the largest and most complex tax systems in the world. And perhaps it will be one that challenges the Federal Government's.

Mr. CANNON. Well, Mr. Rauschenberger, please do respond, but briefly.

Mr. RAUSCHENBERGER. I don't know where he has been because that is not what it does. The city of Elgin in Illinois is not a book on its way out to Lands End or to L.L. Bean to tell them how to manage their store.

Mr. CANNON. But part of——

Mr. RAUSCHENBERGER. If you source the sale to my zip code, all it is going to tell you is 6.75 percent is my sales tax rate, collect it, and remit it. I mean——

Mr. CANNON. Where does he remit it?

Mr. RAUSCHENBERGER. Well, it depends whether he chooses——

Mr. CANNON. Where does the dealer remit?

Mr. RAUSCHENBERGER. If L.L. Bean chooses to hire a certified service provider, the service provider assumes the liability and does all the collection and the remittance and the tax forms for them at no cost. If he chooses to adopt a certified software, he would collect the seller's discount, the reward, the compensation for doing it. And he would collect and remit.

Mr. CANNON. Thank you. I suspect that what would really happen in this context is that we would tend to homogenize sales taxes. And I find that disconcerting in the least.

Governor Spitzer called taxing Internet sales a tax increase. What we are dealing with here is, in fact, taxes that are taking more taxes out of the pockets of consumers. You know, one of the things I just don't understand—let me put this on the record.

I have talked to many individual State tax commissioners. And we have had, I think, pretty broad consensus. It seems to me that the interest of the States is to encourage an environment which has made them flushed, by the way. Virtually all the States are flushed with cash. It has created an environment of economic growth. The Internet does that.

Why would you want to poke the baby in the eye as it is beginning to grow? That is one of the facts I can't understand. Or I understand how as a group States would have wanted to tend to do this. But individually if they thought about it, there ought to be a tendency to say we have a great economy that is growing, let us encourage innovation online and——

Ms. SÁNCHEZ. Mr. Cannon?

Mr. CANNON. Now it actually has expired, hasn't it?

Ms. SÁNCHEZ. Your time has expired.

Mr. CANNON. Thank you. What remains I yield back.

Ms. SÁNCHEZ. No time, so we will put that in the negative account, and we will charge you for that later.

We are being summoned across the street to vote. But I do have one quick question that I think will clarify a statement that Mr. Cannon just made. So I recognize myself for 5 minutes, but won't take that entire time.

Mr. Rauschenberger, I am particularly concerned about the statements similar to the ones Mr. Cannon just made about people thinking that this is a new tax on consumers. And can you please clarify exactly what the SST does?

Mr. RAUSCHENBERGER. The enemies of this reform in States across the country—and you will hear, I think, in Congress that this is a tax increase. But nothing, in my opinion, could be further from the truth.

These are taxes that the Supreme Court says States legally have the right to levy. And they have the right to collect as long as there is reasonable notice to the seller.

We have cured the rise, the increased bar that Bellis Hess and the *Quill* decision raised of simplifying our system so that it is not a burden on interstate commerce and crossing that threshold to be, hopefully, to be blessed by Congress. So this is about—I mean, the same argument could be used of abolishing the IRS and not requiring people to mail in their tax returns.

Ms. SÁNCHEZ. Mr. Rauschenberger, I wouldn't go there because there are Members who would be in favor of that.

Mr. RAUSCHENBERGER. Well——

Mr. CANNON. If I could figure it out.

Mr. RAUSCHENBERGER. These are legally levied taxes that are due from the customers. Sales taxes are not taxes that are unpopular. They win referendum time after time. When local governments—the state of Michigan when they chose to change the way they funded education by referendum, they selected the sales tax. People perceive the sales tax as relatively fair. It is less regressive than property taxes because at least it has indexed the amount of income because you spend more as you earn more. So it is not a tax increase in any way that I can agree to.

Ms. SÁNCHEZ. Thank you. I appreciate that. I will yield back my time.

And I want to thank——

Mr. CANNON. Madam Chair, may I ask unanimous consent to introduce two articles into the record? One, an A.P. article entitled, "Spiked Clarification and Tax Law Aimed to Collect from Web Sales" and one from Forbes, "Point, Click, Pay Tax"?

Ms. SÁNCHEZ. Without objection, so ordered. I want to thank all of the witnesses for their testimony today and for being patient during the interruption to go vote.

[The information referred to follows:]

11/14/07 AP Alert - Political 22:51:44

November 14, 2007

Spiked clarification in tax law aimed to collect from Web sales
VALERIE BAUMAN
Associated Press Writer

ALBANY, N.Y._Days after the state Department of Taxation and Finance quietly issued a memo that would have required many out-of-state online companies to collect sales tax from New Yorkers, Gov. Eliot Spitzer reversed the plan.

"Governor Spitzer believes that now is not the right time to be increasing sales taxes on New Yorkers," said Paul Francis, the state budget director, in a written statement. "He has directed the Department of Tax and Finance to pull back its interpretation that would require some Internet retailers that do not collect sales tax to do so."

The original memo, issued Sunday, would have targeted companies that do online business in New York, but which don't have a brick and mortar presence in the state.

It would have required companies selling products online to register as New York state vendors and collect and report state and local sales taxes from customers who live here if the company has used an online agent or representative physically located in New York to make sales.

When someone located in New York state provides an online link for a product to an out-of-state site _ like Seattle-based Amazon.com _ and receives a commission, New York planned to consider that person a sales representative for the larger company.

State officials did not say how many businesses would be affected or how much tax revenue would be collected.

The state Department of Taxation and Finance said the memorandum's purpose was "to clarify current policy and does not reflect any change in requirements for vendors doing business in New York state."

But Spitzer decided it was not the right move.

Francis said that when deciding to drop the clarification about online, out-of-state sales tax, the governor expressed concern about the approaching Christmas shopping season and the possibility that some people would consider the memo's directive to be a tax change, rather than an interpretation of existing law.

The decision came the same day Spitzer decided to abandon a plan to issue driver's licenses to illegal immigrants, but Francis said the tax decision had nothing to do with that issue, or the governor's flagging popularity.

"It's unrelated," Frances said.

A Siena poll released Tuesday found just 41 percent of New York voters view Spitzer favorably _ an all-time low for the governor who was elected with nearly 70 percent of the vote.

"Businesses depend on a robust fourth quarter to meet payrolls and operating expenses," said Mark Micali, vice president of government affairs for the Direct Marketing Association. "The last thing businesses or consumers need is uncertainty in the marketplace."

The association advocates industry standards for responsible marketing. Micali described the initial idea as an "overreach of authority."

Amazon.com currently charges state sales tax in North Dakota, Washington, Kentucky and Kansas, because the company has a physical presence in each state, spokeswoman Patty Smith said.

The company doesn't break down its sales on a state-by-state basis, Smith said.

Amazon.com officials declined to comment on the New York tax memorandum.

The deadline for online businesses to start taxing New Yorkers would have been Dec. 7. No back taxes would have been assessed.

On the Net: http://www.nystax.gov

Forbes.com

Business In The Beltway

Point, Click, Pay Tax

Janet Novack, 11.28.07, 11:32 AM ET

WASHINGTON, D.C. -

Here's a surprising estimate: Consumers will pay sales tax on half of their online purchases this Christmas.

Avoiding sales taxes has long been one of the lures of shopping online. After all, the combined state and local sales tax levy now averages more than 8.5%, the highest ever, according to Vertex, which sells tax collection software. That average doesn't include Delaware, Montana, New Hampshire and Oregon, which don't have sales taxes.

In theory, a consumer who orders a product on the Web or from a catalogue owes the same sales tax he would if he purchased it from his local store. But the Supreme Court has ruled that a state can only require a merchant to collect the tax if the merchant has a physical presence in the state. That's why Amazon.com, the largest online retailer, collects sales taxes only on items shipped to Kansas, Kentucky, North Dakota and Washington, where it has offices or warehouses.

It's also why the states and the National Retail Federation--an advocacy group for traditional store-based retailers--are pressing Congress to change the law. The House Judiciary Committee is expected to hold a hearing next month on a bill allowing states that sign on to the Streamlined Sales and Use Tax Agreement (a pact meant to make the collection of sales taxes less burdensome) to require all online and catalogue merchants doing more than $5 million a year in sales to collect their taxes. Such legislation has little chance of becoming law before 2009.

Meanwhile, half the sales taxes owed by consumers on the purchases of goods online are being collected anyway, figures William Fox, director of the Center for Business and Economic Research at the University of Tennessee. He bases that estimate on surveys of Web sites he and his students have conducted over the last two years.

"I was surprised to find it was so high. And if anything, it's growing," says Fox.

Fox stresses the states are still missing a lot of tax money--$15 billion a year or more. And with online sales climbing 20% a year, their losses will grow. But state enforcement pressures, combined with traditional bricks-and-mortar retailers' success on the Web, has led to increased tax collection online.

Only three of the 20 largest online merchants in 2006 were pure online operations, according to *Internet Retailer*'s annual rankings. Staples, Office Depot, Sears Holdings, Best Buy, J.C. Penney, Wal-Mart Stores, Circuit City and Target all made the top 20. All collect sales tax.

Limited Brand's Victoria's Secret, which collects taxes, sold more online last year than did Overstock.com, which only applies tax to shipments bound for Utah.

In the early days, some bricks-and-mortar retailers, including Wal-Mart, set up their online operations as separate businesses and argued they didn't have to collect tax. But most later made deals with the states to begin collecting tax.

Non-traditional retailers have started moving into the tax line, too. Dell began collecting sales tax nationwide last year, prompting some grumbling online by surprised shoppers. CDW began collecting in 2005.

By collecting tax, retailers are freer to integrate their online, bricks-and-mortar and service operations. Customers, it turns out, like being able to return a defective DVD player purchased online to a local store.

But once a retailer offers hands-on services in a state, that state has a legal hook to demand its taxes be collected. Last year, for example, a California appeals court ruled that Borders Online owed the state sales taxes it failed to collect from 1998 to 1999 because customers could return online purchases to Borders' California stores.

Borders itself demonstrates the evolution of online selling. Since 2001, Borders has farmed out its online operations to Amazon.com. Amazon sells books under the Borders name, collecting taxes on sales shipped to just four states. Borders gets a percentage of the sales but Amazon handles the fulfillment and shipping.

In the first quarter of 2008, Borders plans to launch its own online site, ending its Amazon deal. Borders spokeswoman Anne Roman says that while the company still disagrees with the California court decision, its new online site will collect sales taxes nationwide. Why? It will have a clear physical presence in the states, with shoppers being given access in Borders stores to the online site. "We're integrating the online and in-store experience," Roman says.

Despite such developments, the states won't rest until Amazon itself caves. So the skirmishing continues. Last month, Illinois' attorney general won a state appeals court ruling that will allow the state to continue to pursue a lawsuit against a laundry list of online sellers, including Amazon.

Earlier this month, New York state's tax department issued a memo asserting that any in-state sales efforts by an independent agent for an online seller would make that seller liable to collect New York tax. Say a New York author links from his own Web page to his book's page on an e-commerce site and gets paid a commission for any sales the link brings in. According to this memo, the e-commerce site would be considered to be soliciting business in New York through the author and would have to collect taxes on all sales shipped to New York--not just sales of that one author's book.

The legally questionable memo prompted an outcry, and Democratic New York Gov. Eliot Spitzer ordered it withdrawn. Score one victory, at least temporarily, for tax-free shopping.

Ms. SÁNCHEZ. Without objection, Members will have 5 legislative days to submit any additional written questions, which we will forward to the witnesses and ask that you answer as promptly as possible so that they can be made a part of the record. Without objection, the record will remain open for 5 legislative days for the submission of any additional material.

And because this is the last planned hearing of the Subcommittee before the winter recess, I want to take this time to thank my Ranking Member, the Members on the dais, and their staff for all of the hard work. And I want to wish everybody a safe and happy holiday season. And with that, this hearing on the Subcommittee of Commercial and Administrative Law is adjourned.

[Whereupon, at 12:29 p.m., the Subcommittee was adjourned.]

APPENDIX

MATERIAL SUBMITTED FOR THE HEARING RECORD

RESPONSES TO POST-HEARING QUESTIONS SUBMITTED TO JOAN WAGNON BY THE HONORABLE LINDA T. SÁNCHEZ, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA, AND CHAIRWOMAN, SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW

Questions for Record
Subcommittee on Commercial and Administrative Law Hearing on
H.R. 3396, the "Sales Tax Fairness and Simplification Act"
December 6, 2007, 10:00 a.m., Room 2237 RHOB

QUESTIONS FOR JOAN WAGNON
From Linda T. Sánchez, Chair

1. One of the arguments against this legislation and the Agreement is whether the states can actually establish a simplified system for businesses to collect sales taxes. What have the states proposed or already offered to simplify the collection of sales taxes for businesses? Is there software which would make the collection easier?

There is no question that the changes made by the 22 SSUTA states to their tax laws have simplified the sales tax system for businesses. The real question is whether they have been simplified enough to remove the burden on business. The Governing Board would argue that they have. The Governing Board has achieved the following simplifications to date:

- √ Common definitions of products and product-based exemptions so that a retailer doesn't have to worry about differences in states exempting or taxing a product such as food.
- √ Common report (Simplified Electronic Return) format which all member states accept.
- √ A rates and boundaries data base which all states update quarterly to inform retailers of the current rates and jurisdictions; if a retailer uses that data base it is held harmless.
- √ A centralized, one-stop multistate registration system for a retailer to use with all member states.
- √ Uniform rules for sourcing and attributing transactions to a particular taxing jurisdiction. The passage of an optional in-state origin sourcing rule provides uniformity which doesn't exist in non-member states using origin sourcing.
- √ Uniform procedures for certifying service providers and certified software on which a seller may rely to determine taxability or use/sales tax rates.
- √ Uniform rules for bad debts and rounding.
- √ Single, state-level administration of all state and local sales and use taxes, including a requirement for a state-level filing of tax returns in each Member State.
- √ A single sales and use tax rate per taxing jurisdiction.
- √ A state-by-state taxability matrix with information regarding terms defined by the Agreement.
- √ Uniform audit procedures for sellers requesting single audit.
- √ Uniform rules and procedures for `sales tax holidays'.

The Governing Board continues to work with the business community to identify areas where greater simplifications can be achieved and those efforts will be ongoing. An example is the task of defining digital goods, which took about 12 months and countless hours in meetings. By defining it in a uniform way, business benefits from the removal of ambiguities in the states' laws. Simplification efforts will be ongoing as technology allows greater and greater opportunity.

Yes, there is software available. Four Certified Service Providers (CSP) have been certified by the board to provide services and/or certified software to registered businesses. The state pays the cost of the CSP or CAS software out of the tax revenues collected for those firms that do not have nexus.

The Board is currently working to begin certifying shopping carts or to develop processes for other internet providers to join in providing technology alternatives. Lack of technology is no longer the barrier it once was.

2. H.R. 3396 contains an exception for small businesses with gross remote taxable sales of under $5 million annually. How would this exception impact state and local revenues? Would this exception cause any administrative problems for the states and local governments?

Researchers at the University of Maryland have suggested that as much as 40-50 percent of all e-commerce sales are made by as many as 5 million small firms with less than $1 million in annual sales. A study done by the State of Washington determined that the threshold in the federal bill would exempt approximately half of its retailers.

National Sales Threshold	Percentage of remote sales under the threshold
$ 10,000	0.4%
$ 50,000	2.5%
$ 100,000	4.9%
$ 500,000	18.3%
$1,000,000	26.7%
$5,000,000	50.1%

The Governing Board created a task force in 2008 to study what would be an appropriate small seller exception. A preliminary report indicates that the threshold contained in the federal bill may be too high. Based on the information to date, the small seller exception contained in H.3396 would eliminate roughly half of the anticipated revenue. The Governing Board believes that as technology progresses, and if the states can provide that technology without cost to the retailer, a smaller threshold might be more appropriate. No final decision or recommendation has been made, however. The Governing Board also believes that it might be more appropriate for it to set the threshold so that it could be changed as circumstances dictate.

There would be many administrative problems created by the threshold, not the least of which is caused by defining these as "taxable sales." Since each state determines what is taxable and not, auditing could be time consuming and expensive.

3. Streamlining state sales tax systems has been an ongoing project for several years now. In your written testimony, you indicate that there are several issues yet to be resolved. When do you anticipate the remaining issues in the Agreement to be resolved?

An example of an unresolved issue is vendor compensation. The same task force studying the small seller exception is also studying vendor compensation. Their report has been received by the Governing Board and will be the subject of much debate during this coming year.

The compensation requirement under the Federal legislation is a huge incentive for business. If firms are compensated for collecting sales taxes on both local and out-of-state sales, many remote sellers will wanted to be included in the sales tax collection system rather than being excluded. Our Task Force is working with business representatives to determine what levels of compensation should be paid to businesses collecting the sales taxes.

Other unresolved issues include the implementation of the telecommunication portion of the federal legislation, how to include Indian tribes, and whether or not to amend the agreement to allow large cities to be treated like states. We are also waiting for three more states to adopt the uniform origin sourcing provisions so that amendment can be activated.

An unresolved issue that has been resolved since my testimony is the establishment of and staffing for the Issues Resolution process.

Another unresolved issue that has been decided is the adoption of the amendments concerning digital goods.

4. Many have criticized this legislation as premature because all of the states have not agreed to a uniform and simplified sales tax system. How do you respond to those criticisms?

H. 3396 requires 10 states and 20 percent of the population as the initial threshold to trigger the collection authority. The Governing Board now has 22 states as members with over 30 percent of the population. Having to wait until every state has agreed to the uniformity and simplicity measures puts all the states in a position of letting the minority overrule the majority. We think we have proved that the system works given that there are certified software providers and over a 1000 businesses registered as volunteers and collecting sales tax for the states. More than $300 million has been collected voluntarily to date. In addition, at least 5 states have expressed interest in joining the Agreement in the near future.

Under the current voluntary system some states, such as Maryland and Florida, cannot become members as they will experience a loss of revenue from some of the streamlining provisions. They cannot recover that lost revenue without passage of Federal legislation and the additional tax collections that will come from the mandatory collection authority.

5. Less than a week after the December 6, 2007 hearing this Subcommittee held on this legislation, the Sales Tax Governing Board met in Dallas, Texas. Please provide a summary of the decisions made at that meeting, provide an analysis of how this affects the progress of the SSUTA, and detail whether this changes any of the testimony provided at the hearing.

At the December, 2007 meeting in Dallas, the Streamlined Sales Tax Governing Board adopted an alternate origin sourcing rule which would be effective upon its adoption by a minimum of 5 states. The origin sourcing rule eliminates the negative impact that would have been felt by small business in Texas, Ohio and other states using origin sourcing. Immediately upon its adoption, the legislatures in Utah and Ohio conformed their states' laws to the SSUTA and were admitted as associate members. The Texas legislature will consider joining the SSUTA in its 2009 session (they were not in session in 2008), as will Illinois, Virginia and possibly Missouri. Throughout 2008 the SST staff and officers have provided assistance to these states in their deliberations.

The action of creating an alternate sourcing rule paved the way for a number of states, including very large states, to join the Agreement. Interest has been high and outreach to many large states, including California and New York has been on-going.

Questions for Joan Wagnon, Secretary of Revenue for the State of Kansas, and President of the Streamlined Sales Tax Governing Board from Chris Cannon, Ranking Member:

1. How many times has the SSUTA been amended? What was the substance of those modifications? Do you anticipate more revisions in the coming years?

The Agreement (SSUTA) has been amended 35 times since its initial adoption in November, 2002. Many of the amendments were accompanied by the creation or modification of rules. Almost all were what might be described as "unfinished work" –issues that were being studied at the time of initial adoption of the SSUTA, but were not sufficiently completed to present to the states' legislatures for adoption. Other amendments repealed parts of the Agreement deemed "unworkable" after their implementation was tried, such as the "multiple points of use" provision.

Most of the amendments have occurred because the Governing Board was attempting to respond to business' concerns. These issues are brought to the State and Local Advisory Council, often by the Business Advisory Council, where they are debated, revised, and finally presented to the Governing Board for action.

It is anticipated that this amendment process will continue, but not at the rate that occurred in the first few years because a significant number of contentious issues have been resolved. Tax laws are never static because the economy is not static.

As an illustration of the kind of amendments being considered, here is a listing of the amendments adopted by the Streamlined Sales Tax Governing Board since December 2007 through 2008:

Definition for ENERGY STAR Qualified Products
Optional origin sourcing rule
Sourcing Rule for Software Term Licenses and Subscriptions
Specified Digital Products definition
Change in sourcing rule for florist sales
Revision of the definition of "Delivery Charges"

2. What are the biggest outstanding issues with compliance with the SSUTA? My understanding is that many localities have concerns about the sourcing rules established by the SSUTA. How are those concerns being addressed?

The biggest barrier to adopting the SSUTA was the sourcing rule that required destination sourcing for both in-state and out-of-state sales Destination sourcing negatively impacted some local governments as well as smaller instate businesses. At its December, 2007 meeting the Streamlined Sales Tax Governing Board approved an alternate origin sourcing rule to be effective upon its adoption by a minimum of 5 states. The origin sourcing rule is uniform and eliminated the concerns from almost all local governments and small businesses. The legislatures in Utah and Ohio acted immediately to adopt the new provisions and were readmitted as associate members. The Texas legislature will be considering joining the SSUTA in its 2009 session (they were not in session in 2008), as will Illinois, Virginia, and possibly Missouri. Throughout 2008 the SST staff and officers have provided assistance to these states in their deliberations.

Creating an alternate sourcing rule paved the way for a number of states, including very large states, to join the Agreement. Interest has been high. Staff have reached out to many large states, including California and New York to encourage them to consider joining the SSUTA.

The other outstanding issues are not really of compliance with the SSUTA, because member states are not admitted unless they are in compliance, but compliance with the federal legislation that has been proposed.

The issue of vendor compensation is a major unresolved issue, but the same task force studying the small seller exception is also studying compensation for vendors. Their report has been received by the Governing Board and will be the subject of much debate during this coming year.

In addition, states are now beginning to focus on the implementation issues involved with the telecommunication portions of the federal bill, as well as consideration as to whether to amend the Agreement to allow Indian tribes or large cities to participate independently.

3. My understanding is that many localities would like a waiver of the sourcing rules for intrastate purchases. How would that impact the uniformity desired by the SSUTA?

By adopting the alternate origin sourcing rule this issue is no longer a problem. States can retain origin sourcing for intrastate purchases, and use destination sourcing for interstate purchases. The origin sourcing rule provides uniformity where there has been no uniformity. The compromise to have two sourcing rules was supported by most in the business community.

While having every state adopt destination sourcing would be the most uniform, it was not practical and would have stymied the inclusion of many of these larger origin-based states. By compromising on a uniform origin rule or a uniform destination rule, with all interstate sales being destination sourced, a higher degree of uniformity was achieved with this practical solution.

RESPONSES TO POST-HEARING QUESTIONS SUBMITTED TO WAYNE ZAKRZEWSKI BY THE HONORABLE LINDA T. SÁNCHEZ, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA, AND CHAIRWOMAN, SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW

JCPenney
Every Day Matters
jcp.com

January 23, 2008

Honorable Linda Sanchez
Chair, Subcommittee on Commercial and Administrative Law
Committee on the Judiciary
2138 Rayburn House Office Building
Washington D.C.

Delivered VIA Email to: Adam Russell
Adam.Russell@mail.house.gov

Re: December 6, 2007 Hearing
H.R. 3396
Review of Transcript and Written Questions

Dear Chairwoman Sanchez:

Thank you for the opportunity to appear before your Committee and present the thoughts of JCPenney and the National Retail Federation on this important bill. This letter is written in response to your letter of December 21, 2007 providing the opportunity to review the transcript of my testimony and respond to two written questions. I have reviewed the transcript and do not request any transcript edits. The following is my response to the two written questions:

Question 1. Some opponents of the SSUTA argue that passage of this legislation would unfairly benefit national retailers at the expense of online only retailers. Please respond.

Passage of this bill would not unfairly benefit national retailers rather it will eliminate an unfair advantage that online-only retailers have over all (especially small) main street retailers. This legislation allows the main street retailer to compete on a level playing field with the online-only retailer who now enjoys an unfair competitive advantage because the state cannot require them to collect the tax due from the consumer. Competitive advantages should come from innovation and value that business brings to the consumer, not from antiquated tax law.

It is difficult to see how the results of this bill can be characterized as an advantage since national retailers only seek the ability to compete on an equal basis under the tax law. The reason the unequal treatment has been allowed to exist until now is that in 1967, the United States Supreme Court viewed the sales tax system as imposing burdens on out-of-state retailers that were so heavy as to impinge on Congressional authority to regulate commerce. In *National Bellas Hess v. Illinois*, the United States Supreme Court found that collecting taxes for over 7500 state and local jurisdictions was too heavy a burden to place on a business unless that business had a physical presence in the state. Few businesses had computers in 1967, and thus the burden seemed obvious and justified the Court's conclusion.

Advancements in computer technology in the 1980's lead the states to revisit the issue of physical presence with the apparent thought that computers might have removed enough of the burden to cause the Court to change its mind. The question was reopened through the case of *Quill v. North Dakota*. As it turns out, the United States

JCPenney
6501 Legacy Drive
Plano, TX 75024

Supreme Court refused to overturn their earlier decision in *Bellas Hess* both because of precedent, and because the *Bellas Hess'* bright line physical presence standard had resulted in reliance on the rule by the business community. The Court in *Quill* went on to point out that Congress was better equipped than the Court to determine if the rule should be changed, and the Court made it clear that Congress had the power to do so.

We would also point out that on-line retailers are, almost by definition, the most sophisticated of computer users - their business model demands it. It is difficult to see why these retailers, who are most sophisticated in the use of the computers that are the tools that best facilitate tax collection, should be believed when they complain that leveling the playing field between them and the main street retailer would put them at a disadvantage.

We are asking for a fair interstate sales tax system – one that treats all sellers the same and imposes the same expectations, burdens and obligations, regardless of how a seller chooses to sell their products.

Question 2: H.R. 3396 contains a small business exception. Why? Are you in favor of including this exception? If you think the exception should be changed, what changes would you propose?

We believe the concern for very small businesses is legitimate and should be addressed. However, we believe that reimbursing sellers for the actual cost of collecting is a better answer to this problem than an exemption for small sellers.

The reason for the small business exception is to assure that responsibility to collect tax would not overly burden very small business. In response to this concern, HR 3396 contains an exception to the requirement to collect for small businesses that sell less than $5 million to out-of-state purchasers.

We agree the concern for very small business is justified because the Joint Cost of Collection Study ("JCCS") in the April 2006 report demonstrated that the current system does in fact impose a heavier burden on small businesses than large. The study shows that the cost of collection was 13.47% of tax collected for small businesses (those with sales of less than $1 million) and 5.2% of tax collected for businesses with sales of less than $10 million. While the overall average cost to larger businesses was 3.4% of tax collected. This study demonstrates that there is a significant burden on all business and we question the equity of attempting to draw an arbitrary line.

The small business exception has created controversy over what size of business should be included. We believe the controversy can be eliminated and a more equitable system created by requiring that sellers be reimbursed or compensated for their costs of collection rather than exempting any group of sellers completely.

The primary reason we believe compensation is a better answer than complete exemption is that reimbursing sellers eliminates any controversy over what constitutes a small seller. If an exception is provided, the threshold question of what constitutes a small seller is a difficult one. It will result in an arbitrary line being drawn at some point, and likely a considerable amount of audit risk and potential litigation. This arbitrary line would force businesses that initially qualify for exemption to be concerned that once a certain level of sale is surpassed, even by $1, the business must suddenly bear all costs of collection. Reimbursement or compensation as a replacement for a small business exception eliminates the situation where a seller might meet the threshold to collect in one year and then fall below it the next, creating problems for the business and government.

The second reason we believe that compensation is a better answer than exemption is that it is more equitable than outright exemption of some sellers. While the cost of collection figures show the costs for small businesses are larger in relation to the amount of tax collected, they are not so large as to dictate a complete exemption from collection responsibility. Using the figures cited above, a business with $1 million in sales would incur about $10,000 in cost for collecting $75,000 in tax at an average tax rate of 7.5%. While this is burden might dictate exemption in the absence of any other solution, if HR 3396 required compensation for this seller, the seller could be fully compensated and the states would still receive $65,000 in otherwise uncollected revenue. We believe this is an acceptable trade-off.

Further, the cost of collection figures cited above are based on the current sales tax system without taking into account the cost reductions that adoption of a streamlined system would bring. Under the Streamlined Agreement, state paid service providers that would calculate, collect and remit the tax are available to these sellers. This would be available at NO cost to sellers that elected to outsource their tax collection responsibility. We believe that this option alone eliminates a substantial amount of the burden and therefore the cost to these sellers, thereby lowering the amount of compensation required and increasing net revenues to the states.

Finally, we believe the requirement for reimbursement or compensation has value in that it would provide an incentive for states to simplify their systems as much as possible to keep the cost of collection to a minimum.

Compensation for all sellers is required by HR 3396, and if properly determined, would compensate small business for the costs imposed on them. We believe that strengthening this provision and requiring the Streamlined Sales Tax Governing Board ("Governing Board") to make a determination as to the proper compensation for sellers based on objectively determined criteria would protect businesses of all sizes from the burdens imposed by the sales tax system at a cost that was affordable to and ultimately controllable by the states.

Again, thank you for the opportunity to speak to this important question. Please let me know if there are any additional questions or if I can be of further assistance.

Very truly yours,

Wayne Zakrzewski
Vice President & Associate General Counsel – Tax
972-431-2122; email: jzakrzew@jcpenney.com

cc: Maureen Riehl, NRF
Del Threadgill, JCPenney

RESPONSES TO POST-HEARING QUESTIONS SUBMITTED TO GEORGE ISAACSON BY THE HONORABLE LINDA T. SÁNCHEZ, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA, AND CHAIRWOMAN, SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW

QUESTIONS FOR GEORGE ISAACSON
From Linda T. Sanchez, Chair

1. Included in your written testimony is a response to studies which you believe overestimate the amount of state and local tax collected on e-commerce sales, and instead, you note that the correct amount should be about $4.2 billion in 2006. $4.2 billion is not an insignificant amount of money. Should state and local governments simply ignore that amount of uncollected taxes? And what would you suggest state and local governments do to collect those uncollected taxes?

2. H.R. 3396 contains a small business exception. Why? Are you in favor of including this exception? Does the exception eliminate the argument you make that the costs of compliance are too onerous for small businesses?

3. One of the arguments against H.R. 3396 and the SSUTA is whether the states can actually establish a simplified system for businesses to collect sales taxes. Please detail that argument. If states were to offer a simplified process to collect sales taxes from all businesses, would you support that?

RESPONSES TO POST-HEARING QUESTIONS SUBMITTED TO THE HONORABLE STEVEN J. RAUSCHENBERGER BY THE HONORABLE LINDA T. SÁNCHEZ, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA, AND CHAIRWOMAN, SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW

QUESTIONS FOR STEVEN RAUSCHENBERGER

From Linda T. Sánchez, Chair

1. On December 5, 2007 the National Governors' Association and the National Association of State Budget Officers released a study indicating that many states can expect budget shortfalls for 2007. How would this legislation affect state revenue collections?

With the growing state budget gaps that are only expected to get worse over the next two to three years, the states need the revenue from what are legally imposed taxes but go uncollected because of the current restrictions put in place by the Supreme Court in the 1992 *Quill* decision. The revenues from uncollected sales taxes could help states and local governments maintain their current levels of police, firefighters, other first responders as well as teachers and health care professionals. We estimate that states are losing between $21 billion to $30 billion in fiscal year 2007. Those lost revenues would help a number of states to close their budget gaps.

2. Some have associated the issues addressed by this legislation with the legislation we just enacted extending the moratorium on Internet access taxes. Are they related, or is there a distinction between the two?

The Internet Tax Moratorium legislation itself makes clear that there is a difference between the two by expressly stating that the moratorium Congress put place on the collection of state and local taxes on access to the Internet does not affect the collection of sales taxes on products bought over the Internet. The federal Internet Tax Moratorium only prohibition on sales tax collection would be if a state imposed a "discriminatory" tax on item, e.g. books bought in a store were not taxable but a book bought online would be subject to sales taxes. There are no states that have ever contemplated such action.

The other major difference is that sales taxes have all been enacted by state legislatures whereas state taxes on access to the Internet (only 11-13 states) were never adopted by a legislative body but were imposed by determinations of state tax departments. Some state legislatures even repealed the tax after their states' tax department ruled that access to the Internet was taxable.

3. In Mr. Isaacson's written testimony, he discussed how the legislation would unfairly burden businesses in states not members of the SSUTA. Is this true? How can we minimize the burden?

It is a false statement. First it is important to remember that the purpose of the Agreement is to reduce and eventually eliminate the burden and costs on all sellers, regardless if they are in state or out of state. Mr. Isaacson's argument is merely a scare tactic, trying to enforce an imagine that the Streamlined Sales Tax effort has failed, that it has failed to achieve its goal. I also should point out that the federal Sales Tax Fairness and Simplification Act as introduced by Congressman William Delahunt of Massachusetts requires compensation for all sellers. States would not be allowed to exercise the federal grant of authority given under the Sales Tax Fairness and Simplification Act until they meet all the simplifications as outlined in the federal legislation and provide compensation to all sellers. Mr. Isaacson knows that but would rather ignore the facts for the sake of his argument.

Finally, it is important to remember that sellers in non-SSUTA states sell into those states. If a buyer in one of those states refuses to pay, the out of state seller will likely use the buyer's state legal system to pursue remedy for non-payment. If the seller can manage to navigate through the legal system, having to collect sales taxes under a streamlined, simplified and a more uniformed system that will not cost the seller to collect should not be any burden.

Questions for Hon. Steven J. Rauschenberger, Past President of the National Conference of State Legislatures and currently at Rauschenberger Partners, LLC from Chris Cannon, Ranking Member:

1. Mr. Rauschenberger, until recently you were a state senator in Illinois. Why has Illinois not joined the SSUTA?

I carried the legislation to bring Illinois into compliance since the Streamlined Sales and Use Tax Agreement was ratified, unfortunately, Illinois has some major changes to comply with the Agreement that could impact current sales tax revenues negatively. This is one of the reasons why we need the Congress to pass the Sales Tax Fairness and Simplification Act as introduced by Congressman Bill Delahunt of Massachusetts. When the federal legislation is enacted, the previously uncollected revenues states will receive will more than offset any possible loss in revenue due to changes in our tax statutes that we need to make to comply with the Agreement.

2. What are the biggest outstanding issues with compliance with the SSUTA? My understanding is that many localities have concerns about the sourcing rules established by the SSUTA. How are those concerns being addressed?

When we began the effort to modernize our state sales tax systems, we had 46 variations on how to administer the collection system. The Streamlined Sales Tax Governing States developed the Streamlined Sales and Use Tax Agreement that provided uniformity to way sales tax are collected while maintaining state sovereignty to decide what is taxed or not taxed and at what rate. Twenty-two states have been able to amend their statutes to comply with the Agreement. However, it would seem the largest obstacle has been the change to a destination based sourcing system for all sales. Prior to the start of the effort to streamline sales tax collection, 18 of the 46 state sales tax systems used origin sourcing for sales, that is the sales tax on a product was determined based upon where the purchase was made, even if it was delivered to another county or city. While some origin sourcing states were able to make the change with little or no problems (Iowa, North Carolina, Washington, Kansas, Arkansas) some other have experienced much opposition from local governments concerned about losing revenues to other cities or towns (Ohio, Tennessee, Texas, Utah).

Last December, the Streamlined Sales Tax Governing Board amended the Sourcing provision of the Agreement to allow limited origin sourcing for in-state sales. This has helped tremendously in moving some of the states like Utah, Texas, Ohio and Tennessee to finalize their compliance efforts.

3. My understanding is that many localities would like a waiver of the sourcing rules for intrastate purchases. How would that impact the uniformity desired by the SSUTA?

As I mentioned in my previous response, the Streamlined Sales and Use Tax Agreement has been amended to allow limited origin sourcing for in-state sales. While it was a slight step away from pure uniformity, the amendment was approved after many retailers from the major chains to small main street sellers argued in favor of the amendment. It also received the support of impacted local governments.

PREPARED STATEMENT OF PAUL MISENER, VICE PRESIDENT, GLOBAL PUBLIC POLICY, AMAZON.COM

Written Statement

For the

Subcommittee on Commercial and Administrative Law
Committee on the Judiciary, U.S. House of Representatives

Hearing on H.R. 3396, the "Sales Tax Fairness and Simplification Act"

Paul Misener
Vice President, Global Public Policy
Amazon.com

December 6, 2007

Thank you very much for permitting me to submit this written statement on interstate sales tax collection. This subject raises important questions of federalism and technology, and requires an appreciation of some details of state sales tax. Amazon.com greatly appreciates the Subcommittee's attention to these questions and details, and herein respectfully offers a few comments, particularly with respect to ecommerce.

US Ecommerce Business Models

Before addressing the specifics of interstate sales tax collection, I think it would be helpful to describe a few relevant aspects of ecommerce business models in the United States. About a decade ago, Amazon.com, eBay, Yahoo!, and other current household names were relatively unknown small businesses, and Google wasn't even yet formed. These small businesses had something in common: technical skills that enabled them to provide content-based services by using the Internet's physical infrastructure and a brand new software application called the World Wide Web. It's no accident that the founders of these companies were engineers. They not only needed a vision, they had to take a complex foundation – the Web – and turn it into something useful to non-technical people. These small business owners overcame the technical challenges of putting up and running a website, attracting consumer traffic to the site and, with the help of electronic payment processors, facilitating retail transactions. At the time, none of this was easy.

But, as these small businesses grew into the big businesses they are today, they vastly simplified the task of getting a small retail business online. Indeed, these companies and others now provide services so that today's small businesses don't have to be technically savvy to make good use of the Internet. With the help of large service providers like Amazon.com, eBay, Yahoo!, Microsoft, Google, and AOL, today's small businesses online need not understand how the underlying technology works nor even directly deal with it.

Several different ecommerce business models now coexist and vigorously compete on the Web. One model is traditional retail, most often by "clicks and mortar" companies that have physical stores as well as a retail website, but also by a few remaining "pure plays," like Amazon.com's core retail business. Another model is "platform" retail, whereby large companies such as Amazon.com, eBay, Microsoft's MSN, and Yahoo! provide ecommerce services to sellers, both large and small. A third important business model is "search" retail, whereby companies like Google and AOL provide online paths and preferred access to thousands of retail businesses.

Incidentally, eBay deserves considerable credit for its success with the platform model. Many people only think of eBay as an auction services provider. Although it's true that no other online auction business comes close to their size and market reach, the genius of the eBay business model was not just in providing variable, auction-style pricing. Rather, eBay also was smart to provide a package of services to businesses that want to sell online without establishing their own website. eBay sells to such businesses (most of which individually are small) marketing, inventory management, sales tracking, reporting, and other services, including some related to sales taxation. Annually, tens of billions of dollars of sales transactions are run through eBay's website.

Federalism and Interstate Sales Tax Collection

The subject of interstate sales tax collection raises important questions of federalism. The issues at hand arise when a buyer is in one state and the seller is in another. Even then, the key sales tax policy questions are reached only if the seller lacks sufficient contacts, called "nexus," in the buyer's state. A transaction under these conditions is known as a remote sale. If the seller has sales tax nexus in the buyer's state, then the seller already must collect tax. If, however, the seller lacks nexus in the buyer's state (*i.e.*, in a "remote" sale), the buyer's state cannot require the seller to collect sales tax and it is the responsibility of the buyer to pay a "use tax." This is true whether the sale is made over the Internet, by telephone, or through the mail. I use the terms "remote," "interstate," and "out-of-state" interchangeably, with the understanding that in each case the seller lacks tax nexus in the buyer's state.

The Supreme Court twice has held that, under the Commerce Clause, it would be unconstitutionally burdensome to allow a state to require out-of-state sellers to collect tax. The Court said that this burden arises out of the fact that the states' current sales tax codes are overly complex and disharmonious. There are thousands of taxing jurisdictions, often with poorly defined geographic boundaries, and each with its own tax rates and arcane rules. The Court held that it would be unconstitutional to require remote sellers to comply with these complicated and heterogeneous codes. But, the Court also made clear that Congress could, at some point in the future, determine that the states' sales tax codes had been changed and made sufficiently simple and uniform, and then authorize states to require interstate sellers to collect.

Three Questions for Policymakers

Thus, in my view, the remote sales tax collection issue presents policymakers three key questions. First, as a matter of public policy, should Congress eliminate the long-held Constitutional requirement that a seller must have physical presence before a state can mandate collection of sales taxes and, thereby, authorize the states to require all remote sellers to collect? Second, if so, have the states adequately simplified and harmonized their tax codes so that there no longer would be an unconstitutional burden on interstate commerce? And, third, is there any justification for requiring only some classes of sellers to collect, but not others?

The first public policy question presented by these circumstances is whether the states *should* be authorized to require remote sellers to collect tax. One component of this question is whether such sales tax collection responsibilities should be borne by private concerns. Every state that has a sales tax also has what is known as a "use tax," which also applies to retail transactions, but rather than being collected by the seller, a use tax is owed by the buyer. Thus, one way for a state government to obtain tax revenue on remote sales would be to improve the state's use tax compliance rates.

The states, however, have preferred to look to Congress for authority to require out-of-state sellers to collect for them. Some have opposed collection outright, saying that, as a matter of public policy, Internet sales should be untaxed, or perhaps *less* taxed. Perhaps there are environmental, social efficiency, public infrastructure utilization, and other reasons to favor Internet sales over brick and mortar sales. By conserving fuel, saving time, and using fewer public roads and other local services, ecommerce arguably should remain under-taxed. For these reasons, it has been said, Internet buyers should be protected from the price increases that tax collection by sellers would cause.

Amazon.com does not have a position on this high level policy question; there are sound arguments on both sides. We concluded over seven years ago, however, that eventually it might be reasonable for policymakers to decide that the tax should be collected by sellers. We also concluded that Amazon would not be hurt by a sales tax collection requirement, so long as the administrative burdens of collection were eliminated through simplification and uniformity, and that tax would be collected on sales via all online business models. Put another way, we've known all along that, because of the inherent consumer benefits of ecommerce as well as our confidence in our commitment to serve our customers, we don't need a sales tax price advantage.

After reaching these conclusions, we decided to help the states in their efforts to simplify and harmonize their sales tax codes, and we were appointed as a private sector representative to the Streamlined Sales Tax Project (the "SSTP"). To my knowledge, we are the only major "pure play" ecommerce company to have cooperated with the states in this way.

The SSTP's work raises the second key question for policymakers: have the states adequately simplified and harmonized their tax codes so that there no longer would be an unconstitutional burden on interstate commerce? It would be difficult to describe all the challenges, proposals, and solutions the states have considered in the SSTP over the past several years. It also would be hard to describe all the tax code changes agreed among over a dozen states in the resulting Streamlined Sales and Use Tax Agreement (the "SSUTA") five years ago, and the many modifications that have been adopted since then. It is not even easy to give a complete picture of how many states have fully adopted the provisions of this pact (at present, there are only 15 compliant full member states). Suffice it to say that, so far, the states in the Agreement have made significant progress, but that most states (including, *e.g.*, California, Texas, Florida, and New York) representing about 80% of the U.S. population, are *not* covered by this work.

Note that the way H.R. 3396 currently is drafted, businesses in states not part of the Agreement would be required to collect for the states that are. For example, California businesses would be required to collect sales tax for Iowa, but Iowa businesses would not return the favor and California would receive no new revenue. The same would apply for all states outside the SSUTA: their businesses would get new collection burdens, but these states would get no new revenue. The current compliant full member states are Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, Nebraska, New Jersey, North Carolina, North Dakota, Oklahoma, Rhode Island, South Dakota, Vermont, and West Virginia.

There are some remaining shortcomings in the SSUTA, including with respect to sourcing of digital goods, sourcing of services and, importantly, costs of collection and vendor compensation. Lastly, issues with respect to returns, lay away fees, and restocking fees, have not yet been addressed.

So, the more precise second question presented to policymakers is whether the simplification and uniformity that eventually may be reached in the SSUTA are sufficient to remove the longstanding unconstitutional burdens found by the Supreme Court. Although Amazon.com believes that even more simplifications must be made, we are most concerned about proposals to move retrograde by diluting a fundamental component of simplification and uniformity: universal destination sourcing. Indeed, although the Project has made considerable progress, we believe that any sourcing approach with different rules for intrastate versus interstate sales would represent a significant step backwards and would fail to provide adequate simplification or uniformity that Congress would need to find in order to overturn the Supreme Court.

Allowing states to have dual taxing systems for intrastate and interstate sales would discriminate against remote sales and lead to confusion for consumers. In many jurisdictions, consumers would face a higher tax burden depending on whether they buy from an in-state or out-of-state seller. Not only would this be discriminatory and confusing for consumers, but such a system would create very different collection burdens for sellers. In-state businesses would have the distinct advantage of locating in a low tax jurisdiction so they can ship to customers throughout the state and only collect the single low rate at their place of business, while Internet and other remote sellers would have to assess the destination rate or apply a discriminatory blended rate.

Amazon.com believes that the Project's fundamental goal of eliminating, not perpetuating, sales tax discrimination, complexity, and inconsistency must not be abandoned this way and that the Project's original decision back in 2000 to adopt universal destination based sourcing represented one of the most important simplifications for remote sellers. We understand the difficulties destination based sourcing creates for some local governments and businesses, but our experiences in both Washington State and Kansas have convinced us that these difficulties can be overcome through the combined efforts of tax administrators and businesses working together to find creative solutions.

The third and last key question is whether there is any justification for requiring only some classes of sellers to collect, but not others? It has been suggested, for example, that small out-of-state businesses be given a blanket exemption from tax collection requirements. Not only would any carve-out necessarily reduce the amount of tax revenue available to the states, any system that requires exemptions because it would be too burdensome for some sellers is, by definition, not adequately simple and uniform. Put the other way, until the system is simple and uniform enough to not require any exemption, there is more work to be done.

At Amazon.com, we are not particularly familiar with transactions involving paper money or substitutes like personal checks or travelers checks, and there may be good reasons to exempt truly small interstate sellers that use such instruments. But we are very familiar with how electronic payment systems facilitate transactions and are confident that the market would respond to help businesses of all sizes meet any new collection responsibility.

So what does this mean for small business? Good news. The Project has always promised to help businesses cover the costs of collection, and the tax calculation and compliance industry already has various types of tax collection systems and services available. Additionally, the large companies that already provide electronic transaction services to small businesses would also gladly provide sales tax collection services, either by themselves or with the help of specialized service providers like Avalara or ADP Taxware. Put another way, given that small businesses operating online or using electronic payment mechanisms already rely on huge businesses for transaction services, it is crystal clear that they also could rely on these same huge businesses to meet a new sales tax collection requirement. So, if the aforementioned policy and factual conditions are met, and the Streamlined Sales Tax Project accomplishes its goal of establishing a simple and uniform sales tax collection system, there wouldn't be any justification for discriminating among large and small retail businesses, at least for transactions online or using other electronic payment mechanisms.

Of course, this discussion so far has been limited to small businesses conducting interstate sales. What about small, "Main Street" businesses selling locally? From the very start of our company, we said that online retail would never entirely supplant physical stores, and we've been proven right. Even after more than a decade of ecommerce, and despite the wild predictions of the late 1990s, still well over 90% of retail sales are *offline*. There are good reasons, of course, including that physical stores provide consumers instant delivery, inform our senses of touch and smell, provide opportunities for socializing, and help bind together our local communities. So, as we consider the implications of tax policy, it is particularly important to consider the effects on Main Street small business.

Presumably, the twin policy purposes of a mandatory remote sales tax collection regime would be (1) to "level the playing field," that is, take away the current price advantage of out-of-state sellers so that local sellers, including small businesses, would no longer be disadvantaged; and (2) to increase state sales tax collections without the states themselves having to beef up use tax compliance. But, if some large class of interstate sellers were exempted from a new collection requirement, both of these policy purposes would be thwarted. Under H.R. 3396, sellers with less than $5 million in annual gross remote taxable sales would be exempt from collection requirements. But on the order of half of ecommerce sales are made by such companies. If such an exemption were adopted, small Main Street sellers would continue to face the price disadvantage of having to collect sales tax while their out-of-state competitors did not, and the states would end up foregoing roughly half of the sales tax revenue otherwise available. Even if the threshold were reduced to $100,000, roughly a quarter of online sales would enjoy a significant price advantage over sales by small Main Street retailers, and the states would be denied the same portion of the available revenue.

Importantly, there would be no good reason for failing these two essential policy purposes of mandatory sales tax collection because, as described before, small businesses online or using other electronic payment mechanisms could just as easily collect the sales tax as their Main Street counterparts who already do. And if any sellers cannot readily collect under this circumstance, the system must not be adequately simple and uniform, and Congress should not endorse it.

In conclusion, the Internet is a great enabler of small business, not just for companies like Amazon.com, which only a decade ago was a small business itself, but also for today's small sellers, which need not be technically savvy to participate fully in ecommerce. Large online companies and electronic payment systems already provide myriad transactional services to small businesses. If the states truly simplify and harmonize their tax codes and Congress eventually decides to allow them to require out-of-state sellers to collect sales taxes, these large companies will be completely capable of providing the necessary tax collection services to small businesses.

Thank you again for receiving this statement. I would be happy to answer any questions you might have.

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LETTER FROM STEVE DELBIANCO, EXECUTIVE DIRECTOR, THE NETCHOICE COALITION

The NetChoice Coalition
Promoting Convenience, Choice, and Commerce on The Net

Steve DelBianco, executive director
1401 K St NW, Suite 502
Washington, DC 20005
202-420-7482
www.netchoice.org

December 6, 2007

The Honorable Linda T. Sánchez
Chairwoman, Subcommittee on Commercial and Administrative Law
1007 Longworth House Office Building
Washington, DC 20515

Subject: **Hearing on H.R. 3396, the "*Sales Tax Fairness and Simplification Act*"**

Dear Chairwoman Sánchez and members of the Subcommittee:

Thank you for permitting me to submit this statement on behalf of NetChoice, a coalition of trade associations and e-Commerce businesses who share the goal of promoting convenience, choice and commerce on the Net. NetChoice members include the Association for Competitive Technology, the Electronic Retailing Association, AOL, eBay, VeriSign, and Yahoo.

In your evaluation of H.R. 3396, please consider the larger question of whether the Streamlined Sales Tax Project (SSTP) has shown that it deserves a Congressional mandate that would impose significant and new tax collection burdens on catalog and online businesses across the nation. *Because that's precisely what the SSTP is asking Congress to do with this legislation.*

SSTP Member states have always known that they could go back to the Supreme Court and attempt to prove that they have truly eliminated the unreasonable burden on interstate commerce that was found in the 1992 *Quill* ruling. Instead, the SSTP states chose to avoid the harsh judgment of the Court, by asking Congress to grant them the power to impose these unreasonable burdens on out-of-state businesses.

Despite six years of effort, the actual simplification achieved by the SSTP is not nearly sufficient to convince Congress that it should abandon its role in protecting interstate commerce. Rather, the SSTP has shown that simplification has become just a slogan – not a standard. Consider these examples of how the simplification campaign has come unraveled:

1. The SSTP Governing Board is now working on a new dual-sourcing scheme to accommodate both origin and destination based taxes at the same time. The Governing Board openly acknowledges that this would be two steps removed from the original simplification vision of one-rate-per-state. The "first step removed" was to allow differential tax rates and rules for over

7,500 individual local jurisdictions, by using destination rates for both interstate and intrastate deliveries.

But that system was still too complex and troublesome for states that base their sales tax on where shipments *originate*, not where they are delivered. To help those origin-based states join the SSTP, the Governing Board wants to retain origin-based rules for intrastate shipments while requiring out-of-state sellers to collect sales tax based on the destination jurisdiction.

To convince us that this is any sort of "simplification" would be a feat of Orwellian 'Newspeak'. Moreover, this could hardly meet the minimum simplification requirements in H.R. 3396, where Sec. 6 (a)(3) calls for *"Uniform rules for sourcing and attributing transactions to particular taxing jurisdictions"*.

2. The cost to businesses that would be forced to implement new systems and to collect, file, and remit the Streamlined Sales Tax could be substantial, a fact that SSTP advocates would prefer to avoid. Ironically, these new burdens would fall most heavily on smaller businesses that depend on the Internet to reach customers in states where they have no physical presence. Moreover, these costs would fall on smaller businesses who are learning to use the internet to compete with the shopping malls and big-box national retailers who are supporting SSTP.

   The minimum simplification requirements embodied in H.R. 3396 would require that *"each Member State shall provide reasonable compensation for expenses incurred by a seller ..."* 6(a)(14). However, the Agreement adopted by Member states does not now require that states compensate sellers for their system integration costs or their ongoing costs of collection.

   Proponents of SSTP should be required to demonstrate whether and how they would compensate sellers in accordance with H.R. 3396. They should also deduct these seller compensation costs from estimates of the new taxes they hope to collect under SSTP.

Above are just two of the most apparent examples of how complex this simplification effort has become. There are other examples involving "replacement taxes" and definitional gymnastics designed to get around simplification requirements. In addition, state tax administrators have used the SST agreement as a way to impose sales tax on items that were not previously taxed.

Still, SSTP member states are again urgently pressing Congress for a nationwide mandate to force all out-of-state retailers to collect and remit sales tax for any goods sold to residents of sates using their so-called "simplified" sales tax system. Their urgency is understandable, since the simplification effort is proving to be much more difficult than anyone imagined. Moreover, the holiday shopping season is upon us, so tax officials are anxious to collect any unpaid sales & use tax on purchases made from out-of-state catalogs and websites.

However, consumers are doing more and more of their online shopping at websites of multi-channel retailers—who already collect sales tax for all the states where they have stores or other facilities. Just last week, this trend was acknowledged by a University professor who was responsible for initial over-estimates of unpaid sales tax. William Fox told Forbes.com that his latest surveys show that half the sales taxes owed by consumers on their online purchases were being collected anyway.

Fox added, *"I was surprised to find it was so high. And if anything, it's growing."* (Forbes.com, November 28, 2007)

In other words, trends in multi-channel retail indicate that unpaid use taxes will become less of an issue—without Congress forcing truly remote retailers to collect for thousands of taxing jurisdictions in other states.

In conclusion, it's apparent that SSTP states have not gone nearly far enough to simplify a system that the Supreme Court found to be an unreasonable burden on interstate commerce. With so much unfinished simplification in sourcing, collection systems, and seller compensation, it is inconceivable that Congress would grant these states the authority they seek to require sellers across the nation to bear their tax collection burdens – even sellers in states that are not SSTP members and particularly sellers in those states that don't have any sales tax at all.

A more reasonable approach would be to amend H.R. 3396 to give Member States some of the authority they seek, but stop short of a national mandate on sellers in every state. Congress could, for instance, require collection not by all sellers, but instead by sellers *in the other SSTP Member States* – essentially approving a voluntary multi-state tax compact. That would at least give Member states a chance to prove they can develop and sustain true simplification. If their efforts are successful, other states will undoubtedly join the SSTP and thereby expand the compact and enlarge their tax revenues.

Thank you for considering our views, and please let me know if I can provide further information for your deliberations on this important issue.

Sincerely,

Steve DelBianco

Steve DelBianco
executive director, NetChoice

PREPARED STATEMENT OF BRIAN BIERON, SENIOR DIRECTOR OF FEDERAL GOVERNMENT RELATIONS, EBAY INC.

The Testimony of
Mr. Brian Bieron
Senior Director of Federal Government Relations
eBay Inc.

Before the House Judiciary Subcommittee on
Commercial and Administrative Law

December 6, 2007

Madame Chairwoman and members of the Subcommittee,

My name is Brian Bieron, and I am the Senior Director for Federal Government Relations at eBay Inc. I would like to thank the subcommittee for giving eBay this opportunity to comment on proposals to dramatically expand the authority of states to require out-of-state businesses to collect and remit sales taxes. eBay believes that this is a critically important issue for millions of Internet users and the hundreds of thousands of small business entrepreneurs across America who are increasingly using the Internet to compete in the 21st Century economy.

In the 12 years since eBay's founding, it has become a premier destination for small business entrepreneurs looking to access a global marketplace. Small business sellers use eBay to reach customers across America and around the globe, and they care about proposals to expand sales tax collection and remittance duties across the Internet because they could dramatically and negatively impact their bottom line.

About eBay Inc.

I am sure many of you here today are familiar with eBay. Whether it was an experience selling or buying online, or purely "window-shopping," eBay has become the World's Online Marketplace, where anyone can buy or sell practically anything on earth. Started in 1995, eBay has now grown to over 248 million confirmed users worldwide, with more than 102 million items listed at any given time in over 50,000 different categories. Last year, eBay members transacted over $52 billion in annualized gross merchandise sales.

As vast and complex as this on-line marketplace may seem, eBay is actually a very easy and user-friendly website in which buyers and sellers are linked together through a variety of on-line offerings of goods and services ranging from books to automobiles. These buyers and sellers come from all across the United States and around the globe truly making eBay a worldwide marketplace.

Small Business Entrepreneurs as eBay Sellers

One of the most important developments on the eBay marketplace over the past few years has been the fact that so many small businesses across America have discovered that the eBay marketplace is a vibrant and valuable place to "do business." As eBay has evolved and grown, it has created new and exciting opportunities for hard working entrepreneurs across America. Currently, over 750,000 U.S. small business people are using eBay today as their primary or a significant secondary marketing channel. We believe that nearly a half-million of them are existing small businesses, in many cases brick-and-mortar stores, and they are using the Internet as a new way to compete and grow. Increasingly, Main Street and the Internet are not competing with each other, Main Street small businesses are using the Internet to compete and survive against large global retail companies. The success of these entrepreneurs is creating jobs and opportunities in communities across the nation.

Many small businesses, whether they are working out of their homes, back offices or in storefronts in towns and cities across America, have realized that eBay offers them a way to access an entirely new market of potential customers. They can get "on-line" without overturning their entire way of doing business, and the marginal costs are not high. Oftentimes they reduce costs by avoiding intermediaries and dealing directly with the customer.

Small businesspeople using eBay to do business are just like all small business people everywhere – they are entrepreneurs, risk takers, innovators and dreamers. They need to be resilient, because even successful small business people are not always successful. They are optimists who bank on the future and their ability to thrive in it. But most of all, everyone in this room recognizes that being a small business person demands hard work.

We are proud that eBay can help America's small businesspeople reach 248 million potential customers, and provide the tools they need to successfully interact with those customers. That's something that was never possible in the pre-Internet world.

The SSTP

As many of you probably know, the stated goal of the Streamlined Sales Tax Project is to increase state tax revenues by simplifying the underlying sales tax laws enough to lift constitutional restrictions on taxing distant sellers. While true sales tax simplification would have real merit, we believe that the reality behind the SSTP is that it is a long way from simplification. As currently structured, the "simplified" system would allow over 7,500 different sales tax jurisdictions and potentially 15,000 distinct rates across America. Businesses that use the Internet to reach customers would be required to comply with the collection, payment and tax filing obligations in all 45 states and the District of Columbia that have sales taxes, as well as the many local jurisdictions.

The SSTP – Why Now?

Before we look behind the curtain at the complexities inherent in the SSTP, I believe that it is important to look at the economic and business landscape. First, the economy is growing, and federal and state tax revenues are at correspondingly high levels. In fact, unlike much earlier this decade, most states are now flush with tax revenues, including sales tax revenue. They are at record levels. While there will always be state and local government officials who will desire more revenue, the SSTP is clearly not driven by state revenue needs.

How about the retail business? The latest figures from the Department of Commerce, available for the 3rd Quarter of 2007, show that total retail sales for the quarter are over $1 trillion, a 3.8 percent increase over the 3rd Quarter of 2006. This is solid growth.

Quarter	Retail Sales (millions of dollars)		E-commerce as a Percent of Total	Percent Change From Prior Quarter		Percent Change From Same Quarter A Year Ago	
	Total	E-commerce		Total	E-commerce	Total	E-commerce
Adjusted							
3rd quarter 2007(p)	1,020,404	34,688	3.4	0.8	3.6	3.8	19.3
2nd quarter 2007(r)	1,012,375	33,477	3.3	1.3	5.9	3.7	20.2
1st quarter 2007	999,534	31,613	3.2	1.7	3.3	3.2	18.8
4th quarter 2006	982,809	30,592	3.1	0.0	5.2	4.6	23.6
3rd quarter 2006(r)	982,936	29,085	3.0	0.7	4.4	5.1	20.9
Not Adjusted							
3rd quarter 2007(p)	1,016,591	32,222	3.2	-1.4	1.2	3.2	18.9
2nd quarter 2007(r)	1,030,508	31,828	3.1	10.3	3.9	3.8	20.7
1st quarter 2007	934,619	30,624	3.3	-9.0	-13.3	3.9	18.5
4th quarter 2006	1,027,047	35,322	3.4	4.3	30.4	4.1	24.3
3rd quarter 2006	984,776	27,092	2.8	-0.8	2.8	4.8	20.1

(Source: US Census Bureau at http://www.census.gov/mrts/www/ecomm.html)

How about on-line retail compared to traditional off-line retail? Now, make no mistake, Internet retail is growing. It accounted for $34.7 billion in the 3rd Quarter of 2007, up 19.3 percent from the 3rd Quarter of 2006. But, the idea that on-retail is about to overtake off-line retail is simply not backed up by the facts.

Consider this: if you look at how much traditional off-line retail grew, the 3rd Quarter of 2007 increased by $38.8 billion over the same quarter in 2006. On the on-line retail side of the equation, the 3rd Quarter of 2007 increased by $6.7 billion over the same quarter in 2006. The numbers are clear. In terms of the actual retail sales, the total of off-line retail actually grew more than $31 billion more than on-line retail.

We should not lose sight of the fact that the gap between on-line and off-line retail is massive. In Q3 of 2007, off-line retail exceeded on-line retail by almost $986 billion, just in the quarter. That means that off-line retail will exceed on-line retail by almost $4 trillion in the year. The actual gap in terms of dollars is so large that even with the two very different growth rates, on-line retail is not actually closing the gap. Off-line retail pulled further ahead.

How can this be? Well, the fact is that 3.8 percent growth of over $1 trillion in traditional retail dwarfs 19.3 percent growth of $34.7 billion in on-line retail. We believe that on-line retail is a tremendous and growing business, but please don't believe anyone who says that on-line retail is putting traditional retail out of business anytime soon.

The Burdens of the SSTP

I believe it is worth spending a moment to recognize the burdens that are implicit in the SSTP. Complying with the SSTP is about more than just calculating how much sales tax is required in each of the 7,500+ taxing jurisdictions. In fact, that might be the easiest part of the burden imposed on small businesses. The reality is that complying with the SSTP would require four phases: Calculation; Collection; Remittance; and Record Keeping.

1. **Calculation** – As I have mentioned, the SSTP allows for over 15,000 sales tax rates in over 7,500 jurisdictions around the country. Today, states change their sales tax rates regularly, and they will be able to change under the SSTP. It will be a full time job just to keep up with the latest state and local changes. In addition, a retailer needs to know the appropriate rate for the appropriate type of product and services. That is enough of a challenge if everything you sell has a UPC bar code. Of course, for many eBay sellers, many products that are sold that do not have a bar code.

2. **Collection** – It is not the same thing to collect the right tax as it is to simply calculate it. When a seller is determining the proper amount of the tax for the particular sale, they then must segregate out the proper tax payment so that it can be sent to the right taxing entity. That collection duty is a burden in and of itself.

3. **Remittance** – This is the next part of the tax collection chain, and with the SSTP it is a major challenge. With so many jurisdictions, and different tax collection entities in each state, it is a major challenge to make sure that the right amount is sent to each agency. And, a business can't just send a lump-sum check and be done with it, they need to have every sale, and every instance of tax, accounted for so that there is the appropriate data behind every check for every sales tax jurisdiction.

4. **Record Keeping** – It is our understanding that the businesses are exposed to potential audits once a year by a state under the SSTP. The advocates express how streamlined this is because it is only one state. But, the reality is that a small business would need to be prepared every year to be audited by every one of the states. That is an unprecedented record keeping requirement.

The SSTP Challenge for Small Online Businesses

As everyone here recognizes, small businesspeople across the country face numerous challenges. This is just as true for the small businesspeople that use eBay. On a day-to-day basis, our sellers must operate with a business model that requires new and innovative methods of communications, customer service and delivery over potentially long distances. In short, we believe that throwing a new administrative and tax collection burden onto their businesses will hurt their ability to succeed.

The fact that this is unquestionably too much for any small business to handle has essentially been admitted by the SSTP advocates from the beginning of the project. SSTP supporters know that a small business could never comply with calculation, collection, remittance and record-keeping on its own, so they presume that technology firms – certified service providers (CSPs) – will do the job for them.

I believe this is a critical point for everyone here to walk away with: SSTP supporters admit that their system won't work unless outside technology companies are involved. If small businesses can't (or don't) use an outside technology, then they basically need to get off the Internet. We think that is a bad sign and a warning to you.

The SSTP advocates claim that they will cover the cost of the CSPs to help small businesses comply with a new complicated tax regime, but if you look at the fine print, there are glaring weaknesses. First, the level of compensation is unrealistically low. The states are talking about compensation on the range of 3 percent of the tax collected, which works out to about .21 percent, one-fifth of one percent, of the price of the product. This level of long-term compensation is completely out of line with what service providers in the financial services field receive for this kind of complicated long-term service.

In addition, the SSTP advocates ignore the range of costs a small business is likely to face in order to make its computer system work with the CSP solution – these are integration, hardware and training costs. It is worth noting that some CSPs have said that they believe these "integration costs" will be their main line of business.

Finally, at the level of compensation being discussed, the level of service that small business will receive will likely be low. And one-size-fits-all is the opposite of the special needs of small businesses.

One final point on the proposed compensation scheme is that it is a clear formula for a classic bait-and-switch, or a "gotcha." The legal burdens will be placed on small businesses, and over time the costs imposed by the service providers go up. The states will refuse to pay – they have no incentive to foot the bill – and the costs are shifted to the small businesses.

Solution – Small Business Exemption

As I have mentioned, the Internet is increasingly an important technology tool helping America's small business entrepreneurs survive and thrive in a dynamic and challenging global economy. We believe that changing federal law to impose a major new tax collection burden on them will hurt their chances for success. We think it would be bad for them, and we think it would be bad for the overall U.S. economy, killing jobs and hurting entrepreneurs in communities across the country.

We believe that federal government policies to promote the growth and success of small businesses help the overall U.S. economy by promoting one of the primary engines of growth, innovation and job creation. That includes federal government policies to exempt small businesses from burdensome regulations and government mandates. With over 750,000 Americans using the eBay marketplace to help run successful small businesses, we believe that a workable and robust exemption for small business is a critical component of any Internet sales tax plan.

As you may know, legislation introduced in the House and Senate in recent Congresses included a "small business exemption." Unfortunately, many of those bills fell short of the mark, setting the exemption at a level that is arbitrary and far below established federal small business size standards. This includes the small business exemption provision included in H.R. 3396. eBay's view has been, and will continue to be, that the small business exemption should be strengthened so that it is reflective of today's thriving, Internet-enabled small business community.

Such an effort was undertaken in the 109th Congress by Senator Byron Dorgan, a long-time advocate of the SSTP concept. His small business exemption proposal, included in S. 2153, was built on a process that eBay believes will protect small businesses.

The Small Business Administration is the federal agency with the mission to help promote America's small businesses and entrepreneurs, and the experience to do this job right. The Dorgan proposal would require the SBA to undertake a rule making to determine how the SSTP small business exemption would be structured and which businesses will be covered. The Congress would retain its critical role and be required to approve the SBA recommendation before the SSTP mandates went into effect. eBay's intention would be to continue to work hand-in-hand with the small business entrepreneurs that use eBay to ensure that an Internet sales tax collection exemption is enacted into law in a way that protects this important engine of growth in our economy.

Conclusion

While this can be a somewhat complex issue, some things are clear:

1. The U.S. economy is strong and growing, and small business entrepreneurs and innovators, using new Internet technologies, are one of the most important engines of growth and job creation.

2. State tax revenues are up and at record levels.

3. Off-line and on-line retail are both growing, and in terms of actual dollars of retail sales, off-line retail actually grew $31 billion more than on-line retail in the latest quarter we have data because off-line retail is still 97 percent of total retail sales.

4. The SSTP is anything but streamlined. It is a very complex system and small businesses using the Internet could never comply without the paid help of technology service providers. The states claim that they will pay those providers, but the amount promised is likely to prove woefully insufficient and would put small business at the mercy of a very unreliable system.

5. A small business exemption to avoid placing a new and burdensome regulatory mandate on small businesses is entirely in keeping with federal precedents and is good policy in this case.

And,

6. The level of an SSTP small business exemption should be based on the existing federal standards and the expertise of the federal agency empowered to protect and promote small businesses.

LETTER FROM THE UNITED STATES TELECOM ASSOCIATION AND CTIA—THE WIRELESS ASSOCIATION

USTELECOM
UNITED STATES TELECOM ASSOCIATION

CTIA
The Wireless Association®

December 18, 2007

The Honorable Linda Sanchez, Chairwoman
Ranking Member Chris Cannon
Subcommittee on Commercial and Administrative Law
United States House of Representatives
Washington, D.C. 20515

Dear Chairwoman and Ranking Member:

On behalf of the members of our respective groups, we would like to express our support for the "Sales Tax Fairness and Simplification Act" (H.R. 3396) and our appreciation for your Subcommittee's consideration of this legislation. The Act provides for fair and simple collection of sales tax and other taxes and fees on telecommunications services and will go a long way to reduce the administrative burdens and costs to businesses that currently collect, remit and pay these taxes and fees.

USTelecom represents innovative broadband companies ranging from the smallest rural telecoms in the nation to some of the largest corporations in the U.S. economy. Our member companies offer a wide range of services across the communications landscape, including voice, video, data and broadband services over local exchange, long distance, Internet and cable networks. CTIA-The Wireless Association is the international organization that represents all sectors of wireless communications - cellular, personal communication services and enhanced specialized mobile radio. CTIA represents service providers, manufacturers, wireless data and Internet companies and other contributors to the wireless sector.

The Council On State Taxation's *50-State Study and Report on the Telecommunications Taxation* documents the excessive burdens faced by the telecommunications industry in complying with state and local taxes and fees. A nationwide telecommunications provider may have to file nearly 48,000 state and local transaction tax returns each year. Complying with these taxes and fees is made more difficult due to the lack of rate and boundary information from the taxing jurisdictions. The Streamlined Sales and Use Tax agreement, as amended, contains a number of simplification measures that ensure that businesses have the information they need to properly comply with the state and local sales tax laws. However, the agreement does not apply the same simplification measures to transaction taxes on communication services.

Tax neutrality principles and the goals of simplification should apply to all forms of electronic commerce, including communications services. The combination of state and local taxes and fees imposed upon communications services imposes significant administrative costs on providers and results in higher costs of service for consumers

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without any corresponding benefit to state or local governments. The Streamlined Sales and Use Tax Agreement made significant progress in recommending simplifications to the sales and use tax and these simplifications should be applied to transaction taxes on communications services. We support the provisions in your bill that would require states and localities to apply the streamlined sales tax reforms and provisions to all state and local transaction taxes on communication services.

The Streamlined Sales Tax Governing Board, along with the other participating states, have shown a sincere effort to address many of the concerns expressed by members of the business community in developing the agreement. We commend the States for their efforts; however H.R. 3396 serves to improve this work by extending the simplification measures to telecommunications providers. We support this legislation and encourage your Subcommittee to endorse these simplification measures and set forth the minimum simplification requirements that should apply to all transaction taxes on telecommunications services by reporting out the "Sales Tax Fairness and Simplification Act."

Sincerely,

Walter B. McCormick, Jr.
President and CEO
United States Telecom Association

Steve Largent
President and CEO
CTIA – The Wireless Association

cc: Chairman John Conyers, Jr.
Ranking Member Lamar S. Smith
Representative William Delahunt